

PROCEEDINGS OF THE NATIONAL
TAX ASSOCIATION

PROCEEDINGS

OF THE

THIRTIETH ANNUAL CONFERENCE ON

TAXATION

UNDER THE AUSPICES OF THE

National Tax Association

HELD AT BALTIMORE, MARYLAND

OCTOBER 25-28, 1937

AND

MINUTES OF THE ANNUAL MEETING OF THE MEMBERS
OF THE NATIONAL TAX ASSOCIATION

HELD OCTOBER 28, 1937

EDITED BY

W. G. QUERY

Secretary

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COLUMBIA, S. C.

NATIONAL TAX ASSOCIATION

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NATIONAL TAX ASSOCIATION

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1937-1938

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Vice-President

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Chairman, South Carolina Tax Commission

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Term Expiring 1938

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Department of Finance of Canada, Ottawa

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CERTIFICATE OF INCORPORATION OF
NATIONAL TAX ASSOCIATION

No. 20264

This is to certify that we the undersigned, all being persons of full age and citizens of the United States and the majority being citizens of the District of Columbia, desiring to associate ourselves for scientific and educational purposes and to that end, to form a body politic and corporate, under the provisions of sub-chapter three of Chapter Eighteen of the Code of Law for the District of Columbia, approved March 3, 1901, and Acts of Congress amendatory thereto, do hereby make, sign and acknowledge this certificate in writing, stating as follows:

First: The name or title by which the association or corporation shall be known in law is NATIONAL TAX ASSOCIATION.

Second: The term for which the corporation is organized is perpetual.

Third: The particular business and objects of the corporation are as follows:

To educate and benefit its members and all others who may be interested in the subject of taxation and the subject of public finance, of which taxation forms a part, by promoting the scientific study thereof generally, by the encouragement of research, by collecting, preserving, and diffusing scientific information and knowledge relating thereto, by organizing conferences and bringing together for discussion public officials, taxpayers and their representatives, students, instructors in universities and colleges and others interested in the subjects of taxation and public finance, by publishing and distributing reports of conference proceedings and such other books, periodicals and publications as may be desirable and helpful for the accomplishment of the purposes of the corporation; by appointing committees for the investigation of problems in taxation and public finance; by formulating and announcing, through the deliberately expressed opinion of its conferences, the best informed economic thought and ripest administrative experience available for the guidance of public opinion, legislation, and administration, on questions relating to taxation and public finance; by acquiring, utilizing, applying, and disposing of property and funds exclusively in establishing, maintaining, improving, and extending the benefits and usefulness of the corporation, through the accomplishment of its purposes, and by promoting better understanding of the common

interests of national, state, and local governments in the United States and elsewhere, in matters of taxation and public finance and interstate and international comity in taxation.

The promotion of the above declared business and objects shall at all times be carried on subject to the following conditions and limitations, by which the corporation and all who shall hereafter associate themselves with it, as members, as participants in its deliberations and activities and in its conferences or otherwise, shall be forever bound; that is to say:

The activities of the corporation shall be non-political and non-sectarian.

No part of the net income of the corporation shall at any time inure to the benefit of any officer or member of the corporation or of any individual or corporation whatsoever.

At any conference which the corporation may organize, members of the corporation shall not be entitled to vote, by reason of such membership, on any matter involving the official expression of the opinion of the conference on a question of taxation or public finance of general public interest, but the voting on such questions shall be vested in such persons in attendance as may be determined by the corporation and be expressed in such manner as may be prescribed by the conference when assembled.

At any such conference, the persons attending shall, by such attendance, be deemed to consent to the condition and limitation that the result of the vote upon a matter involving the official expression of the opinion of the conference on a question of taxation or public finance of general public interest shall not be announced or be given publicity in any report thereof issued by the corporation or be taken as having its endorsement, unless there shall have been full discussion thereof, at that or a prior conference and unless the vote shall represent the substantially unanimous opinion of the conference, which shall be deemed to be expressed by not less than a four-fifths vote.

Fourth: The number of the managers of the corporation, who shall be called the executive committee, shall for the first year of its existence, be sixteen.

Witness our hands this 6th day of January, A. D. 1930.

(S) THOMAS WALKER PAGE

(S) JOHN E. WALKER

(S) WILLIAM P. RICHARDS

(S) ROBERT J. EBY

(S) ALFRED E. HOLCOMB

DISTRICT OF COLUMBIA, SS:

I, Walter F. Studdiford, a Notary Public in and for the District of Columbia, do hereby certify that Thomas Walker Page, John E. Walker, William P. Richards, Robert J. Eby and Alfred E. Holcomb, parties to the annexed and foregoing certificate of incorporation, bearing date the 6th day of January, 1930, personally appeared before me in said District the said Thomas Walker Page, John E. Walker, William P. Richards, Robert J. Eby and Alfred E. Holcomb, being personally well known to me to be the persons who executed the said certificate of incorporation and severally acknowledged the same to be their act and deed.

Given under my hand and notarial seal this 6th day of January, A. D. 1930.

(S) WALTER F. STUDDIFORD,
(NOTARIAL SEAL) *Notary Public, D. C.*

OFFICE OF THE RECORDER OF DEEDS
DISTRICT OF COLUMBIA

THIS IS TO CERTIFY that the foregoing is a true and verified copy of the Certificate of Incorporation of the *National Tax Association* and of the whole of said Certificate of Incorporation, as filed in this Office the 6th day of January, A. D. 1930.

IN TESTIMONY WHEREOF, I have hereunto set my hand and affixed the seal of this Office this 6th day of January, A. D. 1930.

(SEAL) ARTHUR G. FROE,
Recorder of Deeds, D. C.

BY-LAWS OF THE NATIONAL TAX ASSOCIATION

(As adopted Jan. 6, 1930 and amended
Oct. 1, 1936 and Oct. 28, 1937)

ARTICLE I

MEMBERSHIP

SECTION 1. Any person shall be eligible to membership and may become a member, upon application in writing and payment of annual dues for the current year. Such application shall indicate sympathy with the objects and purposes of the association, as expressed in its certificate of incorporation and willingness to be bound by the conditions and limitations contained therein and in these by-laws, *Provided* that the present members of the National Tax Association, an unincorporated association, shall be members, without further action on their part.

SECTION 2. Membership shall be continuing. The annual membership dues shall be five dollars, payable upon application for membership, covering the fiscal year of the association then current and annually thereafter, in advance, on the first day of the subsequent fiscal year.

In the discretion of the executive committee, the annual dues may at any time be increased and the annual dues of residents of any foreign country may be fixed at an amount in excess of those of residents of the United States.

Any member who shall fail to pay his dues within six months from the date when payable shall be considered in arrears and if such failure shall continue for a period of one year, he shall be dropped from membership, for non-payment of dues.

ARTICLE II

ANNUAL CONFERENCE

SECTION 1. An annual conference on taxation shall be held under the auspices of the association, at such time and place as the executive committee may determine. The annual conference shall be the means used by the association for carrying into practical effect its purpose to secure an expression of opinion that will formulate and announce the best informed economic thought and ripest administrative experience available for the correct guidance of public opinion and legislative and administrative action on all questions pertaining to taxation, and to interstate comity in taxation.

SECTION 2. The personnel of each annual conference shall be composed of delegates appointed by the governor or other chief executive of states, public officials having duties with respect to the investigation, enactment and administration of tax laws, instructors and students in universities and colleges, taxpayers and their representatives, and others interested in the subjects of taxation and public finance.

SECTION 3. The voting power of the conference upon an official expression of its opinion is limited, with the purpose of safeguarding the conference from the possibility of having its expression of opinion influenced by any class interest, or consideration for those who devote their time to the work or management of the association, or favor for those who contribute money to its support.

The voting power in each conference upon any question involving an expression of the opinion of the conference on a question of taxation or public finance of general public interest shall be vested in the delegates in attendance appointed by the governor or other chief executive of states. In voting upon such questions each state shall have one vote, and in case of a division of opinion among the delegates therefrom, the vote shall be divided, so as to give proportional

weight, by approximate fractions, to the opinions of the respective delegates.

If the result of such vote shall not reflect substantial unanimity on the subject in question, no publication thereof shall be made and it shall not be considered as expressive of the opinion of the conference. Such unanimity shall be deemed expressed by a four-fifths vote.

Voting by proxy shall not be allowed.

No member of this association shall have the right to vote in any annual conference solely by virtue of such membership.

SECTION 4. One session of each annual conference, or so much of it as may be necessary, shall be devoted to the consideration of the report of the conference committee on resolutions and conclusions. The report of this committee, as adopted by the conference, shall be its official expression of opinion, and it shall not be held to have endorsed any other expression of opinion, by whomsoever made.

No resolution approving or opposing legislation shall be considered by the conference unless it has been discussed at a session of the conference at which it is proposed, or has been the subject of a report made thereon by some committee of the conference or of the corporation, or has been the subject of a resolution adopted by some previous conference.

SECTION 5. The temporary and permanent chairman, secretary, official stenographer, address of welcome and response to the same, meeting place, accommodations for delegates, all necessary preliminary details for each conference, and the program of papers and discussions, shall be arranged for the conference by the executive committee of the association. All other details of the organization and conduct of the conference shall be arranged by the delegates present in such manner as they may from time to time decide.

ARTICLE III

ANNUAL AND SPECIAL MEETINGS OF THE ASSOCIATION

SECTION 1. The annual meeting of the association shall be held in connection with the annual conference, at such time as the executive committee may determine. Sixty days' notice shall be given to all members of the time and place at which such annual meeting is to be held, by publication in the official BULLETIN of the association or by mailing such notice to each member.

SECTION 2. Special meetings of the association may be held at any time and place, when called by the executive committee. At least thirty days' notice shall be given to all members of each special meeting, by publication thereof in the official BULLETIN of the association or by mailing such notice to each member, which notice shall

specify the purpose for which the meeting is called, and no business shall be transacted at such meeting, other than that specified in the notice.

SECTION 3. A majority of all members present at any annual or special meeting of the association shall constitute a quorum for the transaction of business, but such quorum shall at no time be less than fifteen, and whenever the attendance of members exceeds one hundred, twenty-five shall constitute a quorum.

ARTICLE IV

OFFICERS AND EXECUTIVE COMMITTEE

SECTION 1. The affairs of the association shall be administered by a president, a vice-president, a secretary, a treasurer and an executive committee, consisting of the above officers and the three ex-presidents who have last held office, who shall be members *ex-officio*, and nine elected members. The necessary number of the three last ex-Presidents of the National Tax Association, an unincorporated association, shall be members *ex-officio*, so long as necessary to make the number in that class three. The officers shall be elected annually by the members and, with the exception of the president, shall be eligible to re-election. Their terms of office shall begin thirty days after the date of the meeting at which they are elected and they shall hold office until the terms of office of their successors begin.

The elected members of the executive committee shall be divided into three classes, of equal number, each class holding office for three years and until their successors have been elected, provided that at the first election held after the adoption of these by-laws, three classes shall be established, of three members each, to hold office for terms expiring at the time of the first annual meeting of the corporation for the election of officers and of the next two succeeding annual meetings respectively, and thereafter three members shall be elected at each annual election, for a term of three years, and also such additional members, if any, as may be necessary to fill vacancies, to hold office during the remainder of the terms of the members whose places they fill. No member shall be eligible for re-election to the committee to succeed himself, but this provision shall not be applicable to *ex-officio* membership therein.

Two persons residing in the Dominion of Canada may be elected annually to serve as honorary members of the executive committee.

A vacancy in any office or in the membership of the executive committee may be filled by the executive committee for the unexpired term.

The executive committee may appoint such other officers and agents as it may deem appropriate to the purposes of the association, to serve during the pleasure of the committee.

ARTICLE V

DUTIES OF OFFICERS AND COMMITTEES

SECTION 1. The executive committee shall manage the affairs of the association, subject to the provisions of the certificate of incorporation and of these by-laws. All appropriations of the funds of the association must be authorized or approved by the executive committee. Meetings of the executive committee shall be held at such times as the committee may determine. At such meetings a majority of the committee shall constitute a quorum. By order of the president, propositions may be submitted to the members of the executive committee, to be voted upon by mail ballot, with the same force and effect as if voted upon in meetings of the committee.

The executive committee shall have power to appoint standing or special committees and prescribe their duties.

The executive committee shall have full power and authority, in the interval between meetings of the association, to do all acts and perform all functions which the association itself might do or perform, except that it shall not have power to amend the certificate of incorporation or the by-laws.

The executive committee may authorize the president, or in his absence or inability to act, the vice-president, the secretary and the treasurer to exercise all the powers and functions of the committee, with respect to matters and things arising in the routine management of the association, requiring the formal action of the officers, during the intervals between the meetings of the committee.

SECTION 2. The president shall be the chief executive officer of the association and shall preside at the meetings of the association and of the executive committee, and shall perform such other duties as the executive committee shall prescribe.

In case of the absence or inability of the president, the duties of the office shall be performed by the vice-president, and in his absence, by such member of the executive committee as that committee may designate for the purpose.

SECTION 3. The secretary shall keep a record of the proceedings of all meetings of the association and of all other matters of which a record shall be ordered by the association.

He shall issue notices of all meetings of the association and shall perform such other duties as may from time to time be assigned him by the association or the executive committee.

SECTION 4. The treasurer shall keep a complete roll of the members. He shall have the care and custody of all funds and property of the association and shall deposit the funds of the association in such banks or depositories as the executive committee shall designate. He shall, under the direction of the executive committee, disburse all moneys and sign all checks and orders for the payment

of money. He shall, when authorized by the executive committee, execute the papers necessary for the transfer of any property or securities of the association. He shall perform all the acts incident to the position of treasurer and may, in the discretion of the executive committee, be required to give an appropriate bond, at the expense of the association.

His accounts shall be audited by a committee of the association or otherwise, as the association may prescribe, and he shall at the annual meeting make report of the financial transactions of the association for the past year.

ARTICLE VI

PROCEEDINGS AND PUBLICATIONS

SECTION 1. The association shall provide for the publication and distribution of the proceedings of the annual conference.

SECTION 2. The executive committee shall authorize the terms of sale or of distribution of all publications issued by the association.

ARTICLE VII

CONSTRUCTION

The word "state" whenever used in these by-laws shall be deemed to comprise state, territory, the District of Columbia, an insular or other possession of the United States or a place over which the United States exercises extra-territorial jurisdiction, and a Canadian province.

ARTICLE VIII

AMENDMENTS

SECTION 1. These by-laws may be amended at any annual or special meeting of the association by a two-thirds vote of all members present; provided, the full text of the proposed amendment shall have been submitted to the members, either by publication in the BULLETIN of the association or by mailing the same to each member at least thirty days prior to the meeting.

FIRST SESSION

MONDAY, OCTOBER 25, 1937, 12:30 P. M.

PRESIDENT OSCAR LESER, presiding.

PRESIDENT LESER: I call to order the thirtieth annual tax conference under the auspices of the National Tax Association, meeting this year for the first time in the state of Maryland, an honor considered of such importance that we are to be favored today with addresses by the governor of Maryland and by the mayor of the city of Baltimore.

Under the by-laws the president of the National Tax Association becomes chairman of the conference, and the secretary of the association becomes secretary of the conference.

I think it might be well at this stage to remind you that this is not a conference of the National Tax Association. It is a conference promoted by that association, but consisting of delegates officially appointed by the governors of the states. So that when action is taken in any important matter, in the form of resolutions, that action represents not the wishes of a self-perpetuating body, but the opinion of disinterested official delegates. For that reason the resolutions adopted from time to time—and there have been few—have always carried great weight.

There is a further qualification that gives force and emphasis to the resolutions. No resolution may be passed or proclaimed to the public unless it is founded on a report previously made or on a matter which has had full discussion before the conference.

I take this occasion, also, to remind you that the annual meeting of the National Tax Association will take place on Thursday night, when there will be the election of officers and other business pertaining to that association. It is desired that we shall have as large a meeting as possible.

Having gotten through with the dreary part of the ceremony, I come to that which might be called the entertainment feature, certainly something that is going to make you feel good.

The first speaker who will express the feelings of our state at your attendance is not unfamiliar with the subject of taxation. I am told that for years he himself has been a taxpayer, on real estate and other visible property. Not only that, but for three years he was a member of the appeal tax court, after the time that I left that body, and if rumor is correct, he burned the midnight oil in the most intensive study of the science of taxation that ever has been undertaken in this state.

He could really qualify to take part in all of your round tables and in all of your discussions. As governor he has had a very considerable work in connection with budget making, and budget making involves taxation. He could tell you something of the repercussions, the percussions, and the "cussions" that have arisen by reason thereof.

I am greatly indebted to his excellency, and I here publicly acknowledge, as I have done to him privately, that he elevated me to the chairmanship of the state tax commission two years ago, after I had served on it for something like twenty years. I thought he would be fairly well satisfied with what I did, but lo and behold—and I am sorry to confess—he has removed me from that position. I don't bear him any ill will, though, and to show how friendly I am, I am going to stop talking and let him talk.

GOVERNOR HARRY W. NICE (Maryland): Mr. President, Ladies and Gentlemen of the Conference: I am in a quandary as to how I should catalog that eulogy pronounced by my friend, Judge Leser, upon my own innocent head. I don't know whether he was dealing in sarcasm or wit, but he stopped short of the truth in so far as my attitude toward him is concerned. If I were dissatisfied with his work on the tax commission, I certainly played an awful joke on the supreme bench of Baltimore City, because there is where I placed him.

Maryland is indebted to you ladies and gentlemen this afternoon for two outstanding honors. First, you have selected our own good citizen and judge of the supreme bench, Oscar Leser, as your president. That was intelligence. Second, you have selected Baltimore City in the state of Maryland as your meeting place. That was the exercise of rare good judgment.

So it is my very great pleasure to personally and officially extend to you the greetings of the people of Maryland, extend a welcome which is hearty and cordial and sincere. We hope that your deliberations will result in very great good to the people of this country. We hope that the hospitality that we shall be able to extend to you will be of such a nature as to intrigue your fancy and incite your desires for a return.

I should like also to welcome especially to this conference my friend, Governor Cochran, of Nebraska. I have no desire to become fulsome, but I really and truly think that he is one of the outstanding chief magistrates of these United States. I have been brought into intimate contact with him for a number of years. He is a gentleman of pleasing personality, rare intelligence, and sound judgment. These things he brings to bear upon the problems of state government, and I hear that the people of Nebraska were intelligent enough to put him back for another term. I wish him Godspeed in his

efforts, but why he wants to be governor more than once is more than I know.

Maryland doesn't expect you to render its people tax-conscious in your deliberations. Taxes have rendered us unconscious. But we do think that because of your expert knowledge, your interest in the subject, your careful study of its every phase, your efforts will result in a program of enlightenment on this subject that will do the people of this country a great deal of good.

Maryland has been able to hold its own. The city of Baltimore and the state of Maryland have balanced budgets. They both have a sizable and very commendable surplus in the treasury. Maryland bonds have been selling at above par. They have been selling as high as 109, with a yield of 1.87, and we are rather proud of the record. In so far as the state is concerned, the state indebtedness in the form of bond issues as reflected through the tax rate on real estate will, I am glad to say, be between one and two million dollars less in January, 1939, than it was in January, 1935.

Our tax rate has not been raised during the past biennium. It will be raised probably about one cent on a hundred for the next biennium, but that will be solely in order to augment funds for relief, and not for functioning of the state government.

We do hope that your stay with us will be as delightful to you as it is delightful to us to have you, and we hope that you will come back just as soon as you possibly can.

Thank you very much.

PRESIDENT LESER: One of the innovations in the way of taxation that Maryland has experienced is the introduction of the state income tax, not for the first time in its history, but for the first time in a hundred years. We had such a tax one hundred years ago. Fittingly enough when you realize what our position was all through prohibition, how we were the leaders in the movement to get rid of it and I suppose as a sort of a passing compliment to Mr. Volstead we have adopted the rate of one-half of one per cent.

To show you gentlemen coming here from all parts of the United States and the Dominion of Canada—I am very glad to see that our good neighbor on the north appreciates the opportunity of comingling with us—how free we are here in this state, known, as you know, as the Maryland Free State, partly because we are so tolerant of those from other sections of the universe, let me state that our worthy governor hails from the District of Columbia, the mayor of Baltimore City hails from Harford County near the bridge that crosses the Susquehanna River, and I am from Missouri myself.

The next speaker also has had some experience in taxation. Like the governor, who has probably forgotten that he ever was on the appeal tax court, I am sure that the mayor has forgotten that he

ever was a tax collector when he was register of wills in this city. It may not be known to you, but it is known to every man, woman and child in this state, that he harbors a certain ambition. That can well be illustrated by an incident that actually took place. The newspapers one day carried the story that a man had been hailed before a magistrate for disorderly conduct. There were others with him who submitted to trial and were sentenced to fines, but this man declined to join and prayed a jury trial, because, he said, "I will not submit to being tried by a Republican judge."

The paper, incidentally, mentioned the fact that the poor boob didn't know that by appealing his case he would be brought before a Republican judge in the form of yours truly. The name he gave to the magistrate was Howard Jackson, the name of our mayor. Thinking that perhaps something might have happened, I called the mayor up, expressing regret and surprise, but assuring him from the bottom of my heart that if it were he, and he came before me, he needn't fear a Republican judge, but that "justice would be done." You know, justice is exactly what most of them don't want. Whereupon—and this is the real point of the story, gentlemen—his answer was, "You can sentence me to four years in the executive mansion at Annapolis."

I will now call upon the mayor of Baltimore, Howard W. Jackson.

MAYOR HOWARD W. JACKSON (Baltimore, Maryland): Judge Leser, Governor Nice, Governor Cochran, Ladies and Gentlemen: I am very happy to greet you on this occasion. It is embarrassing to follow the governor after he has welcomed you to Maryland, because we are a part of Maryland. We realize that, except sometimes when the legislature is in session. I am very happy to have the governor tell you about the good condition of the state, financially and otherwise. Two things he did were done by him to the benefit of the state. The governor did, and rightly so in my opinion, designate Judge Leser as the head of the state tax commission. Then he made him a judge. As worthy as Judge Leser is, I hope it will be a long while before the Lord makes him an angel.

The judge said now that he was through with the dreary part of the program he would start on the entertainment. You can draw your own conclusions about that. About the only entertainment I am looking forward to is to hear Governor Cochran. I judge from his subject it will be entertaining—"Ways and Means for the Practical Application of Economy in Government." That ought to be entertaining even to the taxpayer, let alone you fellows.

I don't know that I ever faced a group that is punished more by public opinion, unless it is the governor of a state or a mayor. You all have my sympathy.

I would like our tax collector, Tom Young, to stand up to see how much applause he will get from his fellow sufferers. (Applause)

Tom, you didn't get any better reception than you would at a public meeting of taxpayers in Baltimore.

Judge Leser said something, when he introduced the governor, about taxation and its relation to the budget, for he had become involved as governor with budgets and taxation. I don't know anything that involves the budget more than does taxation.

I haven't any particular message for you gentlemen, because I am in a different position than ordinarily. Ordinarily when the governor and I address a gathering we have to assume that the people in front of us don't know anything. Otherwise we wouldn't be able to talk to them. At least they wouldn't listen. You fellows are supposed to know it all, and yet I don't know of any group that knows less than you folks, unless it is the conference of governors and the conference of mayors, which meet occasionally, too.

If you want to know what the public thinks of you, you go out and ask somebody. Unfortunately for you fellows, probably, or maybe fortunately, you don't have to run for office. If you did you would find out what it thought of you, if you ran on your own platform, and that is the record you make in your office. You see, we have to do that whether we like it or not. That must be our platform.

I am very happy to welcome you to Baltimore. You have a lot of interesting subjects here. They are almost too numerous to mention. Someone said to me, "Well, I suppose before this conference adjourns they will solve all these problems."

I said, "They will not, because they are no different from any other group. If they solved all these problems they would be out of a job."

I don't know of anybody that solves all the problems of his office in order to eliminate his job. Therefore, having heard what Judge Leser said, that you passed very few resolutions, I imagine the time is going to be taken up by constructive discussion, without resolutions, of these subjects that are enumerated on your program.

I congratulate you, Judge Leser, on these subjects. There are a lot of them here. I want to hear this one by Governor Cochran. Then I am interested in the one on Expenditure and Budget Control. We can say a lot about that in Baltimore. I hadn't noticed before I left the office that Mr. William J. Casey will participate in the discussion of that subject. Mr. Casey was the vice-chairman of a commission that I appointed in my first administration, known as the efficiency and economy commission.

May I be bold enough, without misunderstanding, to invoke that subject at this particular time? I have been in and around and about the city hall for a great many years. You can get more information about the inside of the city hall by being on the outside most times than you can by being on the inside, because on the

outside they bring it to you, and on the inside they try to keep it away from you.

I know of a great many studies that have been made in this city, as they have been made in yours, and as they have been made of state governments and of the federal government, looking to the reorganization, coordination and so forth and so on, that could be enumerated. Those reports usually are bound very nicely. The one the chief executive receives is probably bound in dark leather, with his name on it in gold letters, and then it finds its place among the other records in the archives, and we are blamed if we hire another man to keep them dusted off.

So I conceived the idea of doing it more practically. I went into the large organizations, which necessarily are the large taxpayers, and there I asked for their experts to study and to make recommendations for the reorganization of the city government. I got a man from the American Wholesale Corporation, formerly known as the Baltimore Bargain House. I got one from the Pennsylvania Railroad, one from the B. & O. Railroad, one from the American Sugar Refinery, one from the Bethlehem Steel Company, and so on until I had thirteen. I could go on and name them. The reason I quit when I had thirteen was because that was my lucky number.

I asked those men to do the job, and I told their superiors they would be compensated for the services of these men, because if the job were done as I thought it could be done, it would bring down the cost of government, the cost of their government. It did pay them, and those thirteen men went to work and did what every executive has to do. They went back into their organizations, after they had laid their basis and formed their committees of engineering, accounting and so forth, and they drew from their organizations men who did the job for them. At one time I had 131 men doing that work, without direct cost to the taxpayers of Baltimore City.

If it had not been, my friends, for the work done by that commission, 1923 to 1927, I do not believe that we could have kept the city in the sound financial condition that it is in, if that ground work had not been laid. You will hear from Mr. Casey on that subject later today.

I take pleasure in welcoming you to a city, as Governor Nice has said, that has always had a balanced budget. In 1923 our tax rate in Baltimore was \$2.97. When I went out of office in 1927, it was \$2.39. Today our tax rate, with a great shrinkage in our taxable base, is \$2.59, and that after giving effect to an appropriation of \$900,000 in excess of any appropriation that we had previously had, for social security, welfare of all kinds, and giving effect to \$900,000 through a pay-as-you-go appropriation.

We have adopted in Baltimore a pay-as-you-go plan of making public capital improvements. In my opinion the only way you are

going to cut down the cost of government is by reducing your bonded indebtedness and doing more of the capital improvements on a pay-as-you-go, rather than on a bond issue basis. We have reduced the bonded indebtedness in Baltimore more than \$13,000,000 in the last four years. In 1938, for the first time almost in the memory of man—so far as I know, I haven't seen any records at the city hall since the city was incorporated in 1797—our debt service appropriation requirement will be less in 1938 than it was in 1937.

An illustration of what I mean is this. There are certain public improvements that cannot be made, as you know, by virtue of the extent of the appropriation required, the kind of improvement, like building a water plant, or a sewage disposal plant, or something that requires enormous expenditures. For instance, we are building a \$5,000,000 tunnel from Baltimore to the source of water supply at Loch Raven. In other words, I differentiate between minor improvements and major improvements—public capital investment.

We have recently paved two streets in Baltimore, Mt. Royal Avenue and Cathedral Street—only part of them, not their entire length. The contract price for the paving of those two streets was \$154,000, in round figures. We had been doing our paving on a forty year loan basis, and, as you know, the life of no pavement is forty years. It is about twenty years. In other words, it is like buying a suit of clothes, agreeing to pay for it in two years when you know it will wear out in twelve months.

The contract price of those two jobs is \$154,000. On the old bond plan, city stock plan, the interest on \$154,000 for forty years at four per cent would be \$247,000. Whereas if we had done it on the forty year loan plan those jobs wouldn't have been paid for in the next forty years and would have cost us \$401,000.

So by our pay-as-you-go plan we are bringing down the amount necessary for debt requirements and the interest on our bonded indebtedness. Therefore, I welcome you to a city that has a balanced budget. I welcome you to a city that has adopted a pay-as-you-go policy. I welcome you to a city that has abandoned no form of service and no function of government that it had in 1929 or prior thereto. I welcome you to a city that is rich in tradition and rich in history and rich in scenery. We hope that you will enjoy yourselves while you are here.

As an indication of how sincere we are about that, may I be permitted to tell you a story that many of my Baltimore friends have heard. It is a story told about a colored boy who was born and raised here, who went away and was gone for about a year. When he came back he sought out his old haunts and his old friends, and they began to ask where he had been. He was loath to talk until finally one fellow said, "Joe, if you don't tell us one place you have been we will think you have been in jail for a year."

He couldn't stand for that, and with due respect to Bostonians, he said, "I visited Boston."

"Did you have a good time?" they asked.

"No."

"Why not?"

"You know those New Englanders, particularly the Bostonians, are very cultured people," he said. "All they ask you in Boston is 'What do you know?' and frequently I was embarrassed." (Laughter)

With due respect to New Yorkers, he said, "I also went down to New York."

"Did you have a good time there?" they asked him.

"No," he said, "you know the New Yorkers are entirely different from the Bostonians. All they ask you is 'What have you got?' and frequently I was suspicious. So," he said, "I came back to Baltimore, where they ask you 'What will you have?'" (Laughter)

That is the way we feel about you folks while you are here and as we want you to feel after you leave us, so that you will want to return again. I am very happy to extend official greetings and personal good wishes.

PRESIDENT LESER: They say you can tell a Bostonian when you see him, but you can't tell him much.

The committee on arrangements, realizing what excellent entertainment we would have today, insisted upon the selection of the finest possible talent to respond. We searched the United States and we found these two. First comes A. J. Maxwell, of North Carolina, who will now respond to the address of welcome. I may say that Mr. Maxwell won't really need the loudspeaker, because you can hear him in Canada without a telephone wire.

A. J. MAXWELL (North Carolina): Judge Leser, Your Excellency, Governor Nice, Mayor Jackson, My Dear Friends, Ladies and Gentlemen: I am sure we are fortunate, indeed it is more than nice, to have this thirtieth annual conference of the National Tax Association meet in this great historical and business and industrial city of Baltimore. We are fortunate in meeting in this city and state so soundly governed, as we have learned this morning, and to have before us the admonition of these examples.

One of the ancient Roman philosophers observed that man is never more like the gods than when building and preserving states, and anyone who makes a contribution to the sound government of his municipality, his commonwealth, and his country, is making a contribution to that great purpose.

We, I am sure, are pleased to meet in this city of Baltimore as an additional expression of honor and affection for the distinguished

president of the National Tax Association, Judge Leser. When quite a young man, some twenty-five years ago I think, I attended my first conference. Judge Leser was at that time regarded as one of the deans of the organization, and I know of no other member or associate who has held the esteem and the affection of the organization more strongly than has Judge Leser. Whatever further judicial distinctions may come to him, I am sure that he will not be able to separate himself from the activities of the National Tax Association.

The honorable mayor refers to the rather discouraging problem that we have in settling these tax problems. We have been settling them year after year. But the more we settle them the more difficult they get. It is rather like the story of the fellow who said that the further down the alley you get the tougher it gets to live in the last house on the road. But we ought not to forget this phase of it: that the more difficult tax problems become, the more they are registering the extent to which government is rendering service to the people. The National Tax Association owes it to itself and to its constituency to make the best contribution that is possible for it to make to the solution of these problems, and, based upon its thirty years of previous history, I am confident that this conference will not be an exception to the rule that it has made fine contributions to this great problem through these many years.

I am sure we are going to have a delightful experience here in this good city of Baltimore, and that when we leave we all will feel like joining in that old ditty, "Back, back, back to Baltimore."

PRESIDENT LESER: As a fitting companion piece I presume that the rejoinder to North Carolina ought to be delivered by a South Carolinian, but they have a way, you know, of getting off in a corner somewhere or in some little room where they have their celebrated conversations. However, our South Carolina specialist* has his task cut out for him, and he isn't making speeches except the kind that we *must* listen to.

We have, however, a fitting companion to the gentleman from North Carolina in a young man from the state of New York. To those who may not know it, let me explain that the state of New York lies on both sides of the Hudson River. This gentleman has been engaged in tax work for many years. When I mention his name, gentlemen, don't think for a minute now that he has been appointed on behalf of the American Legion to go to Montfaucon or Belleau Wood to mark graves there.

I introduce Mr. Mark Graves of New York.

MARK GRAVES (New York): Judge Leser, Your Excellencies, Governor Nice and Governor Cochran, Your Honor the Mayor,

* Referring to Secretary Walter G. Query.

Ladies and Gentlemen: I have been very much interested in that which has been said here. Certain things are not entirely clear to me yet. I am not sure that the governor placed the judge on the supreme bench to improve the bench. He may have had, being a tax expert as he has been proven to be, in mind improving the tax commission.

I am reminded of an old story. I won't repeat it all, but on an occasion after I had finished a talk at a luncheon party—it was a luncheon party of ladies—the chairman of the committee elaborated and told me what a fine program they were planning for the next year. She said she hoped to get better speakers the next year.

Then too, I was immensely pleased with what the mayor said about Baltimore being on a pay-as-you-go basis. You know most cities and some of our states work on the fiscal policy of the young bride and groom. The bride was out to a card party one night and she told the ladies there assembled that her husband bought her everything that credit would buy. Mayor Jackson, evidently you don't operate your city on that basis.

The harmony that prevails between the state administration and the city administration is also quite striking to me, coming from New York as I do where we have several mayoralty campaigns on. I don't like these harsh retorts. I like to hear smooth words, kindly words, and so forth. That is what we have heard here from the governor, who belongs to one of the major political parties—for the time being the dominant party of the state—and the mayor, who belongs to the other one.

Winston Churchill, shortly after he ceased to be a conservative, was attending a dinner one night and was asked to take in a sweet young thing as a dinner companion. On the way in to dinner she said, "Mr. Churchill, there are about you two things which I abhor."

He said, "What are those?"

She said, "The first is your politics and the second is your mustache."

"Well," he said, "my dear young lady, it is unlikely that you will ever come in contact with either of them."

But we are really glad, Governor Nice and Mr. Mayor, to be here with you. We expect to enjoy ourselves—the fame of Maryland and Baltimore with her hospitality is known throughout the country.

I am reminded of a time when the Democratic party was trying to select a place for a national convention. For your information, Mr. Mayor, I also happen to belong to that party. Ollie James extended an invitation on behalf of the city of Louisville. The national committeeman from Denver objected to it on the ground that Louisville would not have the hotel accommodations. He said,

"If you put cots in all the corridors and all over the place you wouldn't have enough places for the delegates to sleep."

Ollie responded in this way: "My dear sir, if you come to Louisville, we are going to give you such a thundering good time that no gentleman would want to go to bed."

It is that kind of a time that we expect to have here in Baltimore. We are satisfied that we will have it because we have traveled with Judge Leser from Boston to Seattle on these conferences, with stopovers in Salt Lake and other places. One thing that has attracted us to the Judge is his patience, his fortitude and his tolerance. Why, I have actually seen him sitting up at two, half past two, and three o'clock in the morning with huge stacks of blue, red and white cylinders in front of him, just trying to make himself agreeable, to be sure that they had a good time—and sometimes take their shirts.

PRESIDENT LESER: Of course, the speaker, when he referred to these colored objects, had reference to my patriotism, because I always like to be surrounded by the red, white and blue.

When he threw out that suggestion that my removal from the tax commission might have been due to a desire to improve it, I have no complaint to make. Any man can say that. But one must know the circumstances under which it was said, and I here call attention to the fact that the gentleman on his right at this table is my successor in the office, who must have been talking to him.

The next matter on the program—and it will be quite brief—is the organization of the conference. The chairman and the secretary have already been selected and there remains, then, only the adoption of the rules of procedure. I will ask Mr. Query to read the rules—they are quite brief—that have been used at other conferences, and I invite you then to act upon them, either to adopt them or to change them as you see fit.

SECRETARY W. G. QUERY: I shall submit for your consideration and approval the rules of procedure which have governed previous conferences.

General. The provisions of the Certificate of Incorporation and By-Laws of the National Tax Association shall govern the conduct of this conference generally, and these rules of procedure shall be considered supplemental to, and subject to interpretation by such provisions.

Discussion. The usual rules of parliamentary procedure shall control. Each speaker shall be limited to twenty minutes, for the presentation of a formal paper. He shall be warned two minutes before the expiration of such period. The time of such speaker may be extended by unanimous consent of those present.

In general discussion, each speaker shall be limited to seven minutes, and such time shall not be extended.

No person shall speak more than once during the same period of discussion until others desiring to speak have been given an opportunity to do so.

Voting Power. The voting power in this conference upon any question involving an expression of the opinion of the conference upon a question of taxation or public finance, of general public interest, shall be vested in the delegates in attendance, appointed by the governor or other chief executive of a state.

In voting upon such questions, each state shall have one vote, and in case of a division among the delegates therefrom, their votes shall be divided, so as to give proportional weight, by approximate fractions, to the opinions of the respective delegates.

If the result of such a vote shall not reflect substantial unanimity on the subject in question, no publication thereof shall be made, and shall not be considered expressive of the opinion of the conference. Such unanimity shall be deemed expressed by a four-fifths vote.

Voting by proxy shall not be allowed.

On all questions, other than those involving an official expression of the opinion of the conference, the voting shall be by all in attendance.

Committees. The receipt of reports made to this conference by committees of the National Tax Association shall not be considered as expressing the opinion of the conference on the subject stated.

The following committees shall be appointed:

(a) A committee of three on credentials, to be appointed by the chairman, who shall designate the chairman of such committee.

(b) A committee on resolutions, composed of one person from each state, to be appointed by the chairman of the conference, who shall also designate the chairman of such committee.

Resolutions. All resolutions involving an expression of opinion of the conference shall be read to the conference before submission to the committee, and shall be immediately referred, without debate.

Definitions. The word "state" as used in these rules shall comprise state, territory, the District of Columbia, an insular or other possession of the United States, or a place over which the United States exercises extra-territorial jurisdiction, and a Canadian province.

PRESIDENT LESER: Gentlemen, what is your pleasure?

MARK GRAVES (New York): I move their adoption.

CARL S. LAMB (Pennsylvania): I second the motion.

PRESIDENT LESER: It has been moved and seconded that the rules of procedure as read by the secretary be adopted. As many as are in favor of that signify by saying aye.

(Ayes.)

PRESIDENT LESER: Opposed, no.

(None.)

PRESIDENT LESER: The rules are adopted.

This brings us, now, to the sweetmeats. I think ordinarily, except perhaps in a middle western state, a banquet like this would be followed by a cordial. But they have not been very sympathetic in the past with sweet cordials in that section. I don't know how it is now.

We are to hear now an address by the governor of Nebraska, the Honorable R. L. Cochran, whose subject is Ways and Means for the Practical Application of Economy in Government. Let me say just one word on that. Some years ago there was a joint meeting of the American Economic Society and the American Historical Association, and the comment was made at that time by Mr. Henry Van Dyke that it was most appropriate that there should be a wedding of those two societies, because economy was largely a matter of history. That is more so today than it was then.

WAYS AND MEANS OF PRACTICAL APPLICATION OF ECONOMY IN GOVERNMENT

GOV. R. L. COCHRAN, NEBRASKA

Government is necessary for the maintenance of organized society. Taxation is necessary for the maintenance of government. These are fundamental truths. In dealing with the subject of ways and means of practical application of economy in state and local governments, I believe we can all agree that there are certain fundamental business-like principles which must be applied to the business of government. We should not spend more than we can afford. We should keep in mind constantly our ability to pay.

Business principles in government require first a proper determination of what services government must provide in the interest of organized society, the total cost of such services making up a budget; and second, a sound system of taxation to provide the funds necessary for that budget together with efficient administration of the funds so raised. A simple tax structure provides the greatest opportunity for the application of these sound principles of government financing. Economy in government is and always will be simply a wish, unattainable without first a proper determination of those governmental responsibilities to be financed by taxation. The

determination of what properly constitutes a governmental responsibility is a first requisite of economy in government.

Taxation to support all units of government from the school district to the larger units, up to and including the state, tends to increase as society becomes more complex, as the demands of the people for more service through government constantly increase.

First among the recognized responsibilities is the education of our youth. Throughout the nation an elementary education is not only recognized as a governmental responsibility, but it is, in fact, made compulsory. Provision is made for high school education; encouragement is given to higher education in universities and colleges maintained for the most part with public funds. In my own state, 58% of the property tax, which constitutes our principal source of revenue, goes for educational purposes.

Another generally recognized responsibility of government is provision for care of the unfortunate. Until recent years, this has been recognized by law and practice as a family responsibility first and next a responsibility of local government. The tendency in recent years has been to shift this responsibility to the state government; to the federal government. While conditions during the past few years might have justified this change in policy and in extreme cases might still justify it to some extent as a temporary expedient, I sincerely believe we should get this responsibility back to its original status, at least in a substantial part. Other essential responsibilities of organized society are protection of public health, preservation of law and order, and internal improvements.

Pressure to increase governmental activities and thereby to increase governmental expenses comes from two directions: from expending agencies within and from minority pressure groups outside. It is easy and natural for any expending agency of government whether for education, social security, charitable and penal institutions, public assistance of any kind, highway construction or any one of the other expending agencies to become enthused over a particular activity. The demand may be for a new activity; the demand may be for increased expenditures under an old activity. However, none of these expending agencies is apt to see the total cost of government, hence the necessity to view all of these activities in the light of the total cost. In this day of multitudinous organizations, when new organizations are formed over night for the purpose of bringing pressure on the governor, pressure on the legislature, pressure on the administrative agencies of the political subdivisions, even pressure on a reluctant citizenry to add new burdens to government, it becomes the duty of the executive authority, of the legislative authority, and of the local governing bodies to scrutinize all such demands. It is their duty to think not only of the benefits to the minority, but of the costs to the majority, the taxpayer and his ability to pay the total cost.

It must be remembered as a truism, vital though simple, that every governmental activity must be paid for by taxation in one form or another. It seems to me, therefore, that before an appropriation for an existing agency is increased or before additional taxing authority is granted by legislation to political subdivisions, before any new activity is taken on by government, state or local, in short, before the purse strings are opened wider, every such demand, whether state-wide or local, should be found to be essential to the needs of organized society and within the ability of the taxpayer to pay. Care and watchfulness become more necessary as society becomes more complex, making it increasingly difficult to distinguish between the essential and non-essential before it becomes a governmental responsibility. Practical economy in government must start by minimizing the responsibilities of government.

You may be interested in knowing how we have attempted to achieve economy in Nebraska by the application of this principle. Our fiscal policy in Nebraska has three distinct features: first, a pay-as-you-go plan for the state; second, constitutional and statutory limitations on local spending; third, a simple and understandable tax structure preserved by an unyielding opposition on the part of the people of Nebraska to so-called new forms of taxes, such as a general sales tax or a state income tax. By following this policy we have discharged the responsibilities of government including full cooperation with the federal government in the building of roads and in carrying out a social security program.

Nebraska, like all other states of the union, has received great benefits from the federal government during the past few years. Because of the serious curtailment again this year of production of agricultural products in our state, which is primarily agricultural, this situation makes necessary a continuance of federal assistance from existing agencies and existing appropriations.

Our pay-as-we-go plan is probably the most important reason for Nebraska's present enviable position of solvency. It rests upon a constitutional prohibition against state indebtedness, a prohibition which we have constantly maintained. The people of Nebraska have jealously and wisely maintained this provision throughout the period of our statehood.

Pursuing this policy we have demonstrated that it can be carried out and at the same time secure much needed improvements. Witness our ten-million-dollar capitol recognized as one of the world's ten outstanding buildings, our \$103,000,000 state highway system with 8,000 miles of surfaced highways, over 2,000 miles of which is permanent pavement, our state university, four state normal schools, eighteen institutions of a charitable and penal character, all paid for when completed, leaving no burdensome debt as a charge against the future when revenues may be uncertain. These expendi-

tures represent an investment of \$151,000,000, financed on a pay-as-we-go basis.

Bolstering this prohibition against debt are numerous other constitutional and statutory safeguards which have led to practical economy in our state government. Among these, most important is the constitutional provision requiring the governor to submit a budget to the legislature. The governor receives requests from the various expending agencies, and he holds hearings. The governor's budget is subjected to study of legislative committees and to the legislature as a whole with provision that no item can be increased except by a sixty percent vote. Another safeguard which guarantees a balanced budget is the statutory requirement that the state board of equalization shall make an annual levy sufficiently high to meet appropriations made by the legislature against property tax revenue.

A second major point in our fiscal policy is constitutional and statutory limitations upon local spending. These have proved to be effective curbs on local expenditures, practical aids to economy, helping to keep governmental expenditures within our ability to pay. These limitations apply to the county, the municipality and the school district. They apply to bond issues and to annual levies for maintenance.

No local subdivision can issue bonds without an approving vote of the people. In recent years the legislature has tightened this safeguard by requiring in some cases a 60% vote. County budgets are required. No expenditure can be made for anything not included in the county budget. The annual levy must be sufficient to finance the budget. To show that we in Nebraska seek constantly greater economy in government, the last legislature enacted a law requiring a more complete audit of county finances annually by the state auditor. With the thought that members of the legislature, as well as the general public, should be fully advised in regard to all phases of the problem of taxation and suggestions for improvement, the state legislative council has agreed to make a factual study of tax matters, both state and local. The data from such study are to be made available to the general public as well as to the members of the next regular session of the legislature.

The third characteristic of our fiscal policy in Nebraska is a simple and understandable tax structure based upon a property tax. A property tax embracing real, personal and intangible property is the principal source of revenue for state and local government of Nebraska. For counties, municipalities and schools the property tax is, aside from fees, licenses, and minor items, the exclusive source of governmental revenue.

We have refrained from new forms of taxes such as a general sales tax or a state income tax. Many states have adopted one or

both of these methods of taxation as so-called replacements for a property tax. A comparison of the property levy in our state with those of other states, however, shows that, generally speaking, we have a lower property levy. For instance, the Burlington Railroad has given the following figures as the 1936 average rates per \$100 in six states in which it operates west of the Missouri River: Colorado, \$2.885; Kansas, \$2.159; Montana, \$6.445; Nebraska, \$1.900; South Dakota, \$3.245; Wyoming, \$2.195. Yet, out of the states mentioned, excepting Nebraska, there isn't a single one which doesn't have either a general sales tax or a state income tax, and practically all of them have both. This indicates to me that as a rule these so-called new forms merely mean more taxes and more governmental expenditures. We feel that the income tax field should be reserved to the federal government. We feel that this is particularly true because of the possibility, if not the probability, that the federal government will find it necessary to look to this source for increased revenue in the future.

We often hear it said that taxes are painful. I am not sure but that taxes should be painful in order to make the people tax-conscious. The general sales tax lays its heaviest burden on the men and women who toil, and because this tax is paid painlessly with each purchase, the revenue is oftentimes spent less carefully than the revenue from more painful taxes where the citizen is watchful and conscious of the total annual cost. Experience has shown that levying a general sales tax and a state income tax on top of a property tax is conducive to more liberal spending and therefore increased costs of government.

By avoiding bond issues on the part of the state we are able to use current revenue to meet current operating costs, rather than using current revenue or a portion thereof to meet indebtedness, while seeking frantically to devise new ways to meet current costs. This policy has made it possible for us to expand or retrench at any legislative session to meet changed conditions. During this entire period of depression our state obligations have been met promptly without the registration of warrants. In fact, we have been able to reduce taxes in Nebraska. Whereas in 1927 the total of all property taxes levied and collected by the state and its political subdivisions was 66 million dollars, the total for 1936 was 44 million dollars, a reduction of approximately one-third.

There is another important aspect to a pay-as-you-go policy. Such a policy permits a program of long-range planning for public improvements—a program which would contribute to the state's and nation's economic stability. We have seen demonstrated the fact that bond issues on a large scale are usually voted during so-called flush periods and paid for during periods of stress. The bonded indebtedness of Nebraska's subdivisions was decreased be-

tween 1929 and 1936 from 113 million dollars to 79 million dollars, a reduction of 34 millions of dollars during a period of depression. We know that bonds issued during flush periods carry high interest rates. During these periods, materials are high, and there is no unemployment problem. But, these same bonds are paid for during periods of unemployment and during periods of low prices. Deferred public improvements would constitute a back log of construction which could be drawn upon in depressed times to stimulate business and to create employment at a time when construction costs are favorable. I think it can be said that it would be wise for the local subdivisions to follow the proven policy of a pay-as-you-go plan. Thus, public improvements would be constructed at lower cost with the payment distributed over periods of prosperity as well as of stress.

In conclusion, experience shows that among ways and means of obtaining practical economy in government are:

1. Resistance to pressure groups seeking greater expenditures.
2. Constitutional and legislative limitations upon spending by local subdivisions of government.
3. Efficient administration.
4. Avoiding new forms of taxes which usually result in additional taxes and certainly heavy administrative costs.
5. A pay-as-you-go plan for all state expenditures and for local subdivisions of government, except in case of extreme emergencies.

PRESIDENT LESER: I desire to announce that the committee on credentials, which of course must function early in the proceedings, will be composed of Carl S. Lamb of Pennsylvania, chairman, Miss Lois Query of South Carolina, and Albert W. Ward of Maryland.

The committee on resolutions is composed of one member from each state delegation. The opportunity is given to each state delegation to name their own representative, if they do so promptly. If they don't do it promptly, the chair will make the selection. It is, however, the function of the chair to name the chairman of that committee. In conformity to a long established custom that goes back beyond the memory of man, I name Ex-Governor Bliss, of Rhode Island, as the chairman of the resolutions committee. He is not yet present, but I am told that he will be here.

The nominations committee under the by-laws consists of the ex-presidents of the association who are present at the conference and of three additional members. As to that, I shall defer making the selection.

The secretary, Mr. Query, desires now to make some announcements, and among them will indicate where the round table discussions are to be held. They will take place immediately after the adjournment of this session.

(Secretary W. G. Query made some announcements.)

PRESIDENT LESER: I will entertain a motion to adjourn.

(A motion was duly made and seconded that the meeting adjourn.)

PRESIDENT LESER: It has been moved and seconded that we adjourn. As many as are in favor of adjournment vote aye.

(Ayes.)

PRESIDENT LESER: The session is ended.

SECOND SESSION

MONDAY, OCTOBER 25, 1937, 3 P. M.

ROUND TABLES

NOTE.—The interest shown in the round table discussion during the 1936 conference prompted the program committee charged with arranging the 1937 conference to devote the second session to group meetings. Following the presentation of papers or talks by invited participants, discussion by the delegates attending evidenced keen interest in the subjects scheduled. The following is a résumé of the proceedings of the group meetings.—THE SECRETARY.

STATE INCOME TAXES

Presiding Officer, GEO. E. WALLACE,
Member, Minnesota Tax Commission *

PRESIDING OFFICER: We are to take up for discussion at this time the subject of state income taxes. A great many of the problems facing the states do not concern the federal government with reference to income taxes. States must use extreme caution relative to state boundary lines and avoid the taxation of interstate commerce, while the federal government ignores state boundary and is privileged to tax interstate commerce.

Then the states have the most difficult task of allocating income where the taxpayer's business is transacted both within and without the taxing state. The laws of the states generally do not provide a method of allocating such income. In some states an allocation formula is enacted and also provides that in case such formula does not clearly reflect the income within the state, then the taxing officials shall use some other form of allocation which will more clearly represent the portion to be taxed by the taxing state. Such methods of allocation have been based upon the proportion of the sales within the state as compared to the total sales within and without the state. Other factors of allocation are designated as the proportion of tangible property in the state, as compared to total tangible property, and also the same method is applied using payrolls. Where there is nothing in the law to the contrary, a composite fraction consisting of sales, payrolls and tangible property is used, and where this is done such factors are given different weights in accordance with the judgment of the taxing officials.

* Digest of proceedings prepared by presiding officer.

Within recent years a new question has arisen concerning the power of states to tax federal government instrumentalities and the income of federal employees thereof, particularly the so-called government alphabet agencies, and also the question of reciprocity between states.

We will now proceed to discuss all of these most interesting questions, and W. R. Bradley, director of the income tax division of the South Carolina Tax Commission, will be the discussion leader. (W. J. Conway, chairman of the Wisconsin Tax Commission, was on the program to present a paper on "Allocation of Net Income," but being ill was unable to be present and did not send his paper. He has promised to submit this for the record later on.)

Frank M. Keesling, counsel for the Franchise Tax Commission of California, presented a paper entitled "Reciprocity between the States," as follows:

RECIPROCAL CREDIT PROVISIONS OF STATE INCOME TAX LAWS

FRANK M. KEESLING

The necessity for provisions in state income tax laws allowing credit for taxes paid or payable to other states arises from the fact that many of the states tax income from sources within the state of both residents and non-residents and also tax income of residents from sources without the state. Thus, it may frequently happen that a resident of one state who derives income from sources in another state will be taxed on the same income in both states. This discriminatory multiple taxation could be avoided if the states would either confine their taxes to income from sources within the state, thus foregoing the taxation of income of residents from extra-territorial sources, or would confine their taxes to income of residents, thus foregoing the taxation of income of non-residents from within the state. The first method, however, i. e., the taxation of income from sources within the state only would result in discrimination against persons who derive all their income from sources in one state. Such persons would pay taxes at rates graduated according to their total income. Even if all the states had income tax laws at equal rates, the total taxes paid by persons who derive income from several states would not, since the rate in each state would be based only on a portion of the total income, equal the tax that would be paid if the income were all taxable in the state of residence. Furthermore, income from sources within any particular state may not actually represent net income due to losses in other states. Thus, under the first method both resident and non-resident taxpayers may frequently be required to pay net income taxes even though they actually have no net income and, accordingly, no ability to pay.

Adoption of the second method, i. e. confining the tax to income of residents avoids the foregoing objections. This method, however, will result in discrimination against residents since the income from sources within the state of non-residents whose state of residence does not impose an income tax will not be taxable in either state. Accordingly, it would seem that if state income tax laws are to apply equitably, both methods must be followed. The resulting discriminatory multiple taxation can be avoided by the states allowing a credit against the taxes imposed on income of non-residents for taxes paid or payable on the same income to the state of residence. It may possibly happen that the tax on income of a non-resident from sources within the state may equal or exceed the tax on the same income imposed by the state of residence. Thus, although taxes on the same income will be paid to two states, there will actually be no double taxation since the tax in the state of non-residence will be reduced by the credit in an amount equal to the taxes imposed by the state of residence.

If all the states having income tax laws allowed non-residents credit for taxes paid or payable to the state of residence, there would be no need for any of the states to allow residents credit for taxes paid other states. Many of the states, however, tax the income of non-residents and do not allow credit. Furthermore, it is unlikely that this situation will be materially changed in the near future. Under these circumstances, it would seem necessary for the state of residence to allow its residents credit for taxes paid or payable to other states in order to protect them from discriminatory multiple taxation. In adopting resident credit provisions, however, extreme care should be taken to limit the credit to taxes paid other states which do not allow non-residents credit. If this limitation is not made and the credit is allowed even though other states allow non-non-residents credit, a very perplexing and confusing situation will result. Suppose that state X allows credit to residents and state Y allows credit to non-residents. Suppose further that A, a resident of state X, derives an income of \$20,000 from state Y and that the taxes in each state on this income amount to \$1,000. If each state allows a credit for taxes imposed by the other before any deduction for credit allowed by the other is made, A will be entitled to a credit of \$1,000 in each, i. e. the amount of tax imposed by the other, and thus actually will not be required to pay any tax to either state. If it is attempted to limit the credit in each state to the tax actually owing to the other state over and above the amount of any credit allowed under the laws of such state, an impasse will be reached.

To determine the amount of credit allowed by either state it would first be necessary to determine the amount of tax owing to the other state in excess of the credit allowed. This determination

could be made, of course, only by first determining the amount of credit allowed, which in turn could be ascertained only by first determining the amount of tax owing to the first state in excess of the credit allowed by it and so on *ad infinitum*.

The Gordian knot could be cut if one state allowed a credit for taxes paid or required to be paid to the other after deducting any credit allowed by that state and the other allowed a credit for taxes payable to the first state before any deduction for the credit allowed by the first state is made. As a matter of fact most states which allow residents a credit confine the credit to taxes paid to other states and, on the other hand, most states which allow credit to non-residents allow the credit for taxes payable to the state of residence. Presumably, these provisions are based on the assumption that in case of conflict the state of non-residence should yield to the state of residence.

The provisions would operate smoothly in the above example. Since the tax payable to state X, the state of residence, before making any deduction for credit allowed, is \$1,000, A would be entitled to a credit of \$1,000 against the tax imposed by state Y, the state of non-residence. Thus the tax liability of state Y would be extinguished and A would accordingly not be entitled to any credit against the tax imposed by state X. Hence, A would be required to pay the full tax imposed by that state.

Suppose, however, that the rates in state Y were higher than in state X and as a result the tax imposed by state Y amounted to \$2,000. Under the above provisions A would be entitled to a credit against this tax for the \$1,000 tax payable to state X. Thus the tax would be reduced to \$1,000. Notwithstanding the reduction, if A paid \$1,000 to state Y, he would be entitled to a credit of \$1,000 against the tax imposed by state X. As a result A is enabled to satisfy the taxes imposed by both states, amounting to \$3,000 by the payment of but \$1,000, whereas under any sensible application of credit provisions A should be required to pay \$2,000, the amount he would have been required to pay to state Y if that state alone taxed the income in question.

Limiting the credit in all cases to taxes actually paid other states is likewise unsatisfactory. Under such a limitation taxpayers would be free to determine the states to which they should make their payments. Thus, if in the first example above A paid the tax imposed by state Y, he would be entitled to a credit in state X. Hence, Y rather than X would obtain the tax. If, on the other hand, A paid the tax to state X, he would be entitled to a credit in state Y, and accordingly X rather than Y would obtain the tax. Any system which permits the whim and caprice of individual taxpayers rather than provisions of state laws to determine the state to which they shall be liable for taxes, seems haphazard to say the least.

Confusing and perplexing problems resulting from conflicting credit provisions have actually arisen in a number of cases. These problems would be avoided if the states which allow residents credit would limit the credit to taxes paid or payable to states which do not allow credit to non-residents. Unless all of the states which allow residents credit do adopt such a limitation, conflicts in the application of credit provisions will continue to arise. Hence, it would seem advisable for the states allowing credit to non-residents to take steps to avoid such conflict. This can be done by amending non-resident credit provisions to deny credit for taxes imposed by the state of residence if that state allows its residents credit for taxes imposed by other states, irrespective of whether such other states also allow credit. Under such a provision, non-residents would be allowed credit for the taxes imposed by the state of residence if that state did not allow residents credit. Credit would likewise be allowed non-residents where the state of residence allowed its residents credit generally but denied them credit in cases where their residents are entitled to credit in the state of non-residence. If, however, the state of residence allows its residents credit, regardless of whether they are entitled to credit in the state of non-residence, no credit would be allowed in the state of non-residence.

Allowance for credit both to residents and non-residents even with the above limitations may be objected to on the grounds that the state will be yielding both in the case of residents and non-residents to states which allow credit to neither. To overcome this, it would seem proper for the states to allow credit to non-residents only on a reciprocal basis, i. e. only if the state of residence allows credits to non-residents. At the last session of the California legislature, the credit provisions in the California Personal Income Tax Act were amended to embody the foregoing suggestions. It is believed that the amended credit provisions will prove workable and satisfactory.

W. R. BRADLEY (South Carolina) raised the question as to whether or not the states could adopt a uniform basis of allocating income of corporations doing business in more than one state.

LEO MATTERSDORF (New York), answering Mr. Bradley's question as to whether the states could adopt a uniform basis for allocation of income of corporations, said: I feel that this can be done. At the outset, may I say that the discussion of this question by the National Tax Association reminds me of Mark Twain's remark about the weather—everyone talks about it, but no one does anything about it. In approaching the problem the states will have to do two things, namely, (1) make an honest effort to get together, and (2) forget their petty jealousies and not insist in each case

that its own method of allocation is the one and only method. If the question were settled, I believe it would be a great boon to taxpayers, for the reason that it would result in certainty of taxation—that is, taxpayers would know that only 100% of their total income would be taxed instead of 400% or 500% as is so often the case at present. I believe I can state that if this reform were accomplished many corporate taxpayers would even be willing to pay a higher rate of tax. That might be necessary, because the individual states may have to give up some revenue in adjusting their present formulae. I submit, Mr. Chairman, that if approached in the proper spirit this problem can be solved, and, for the good of the taxpayers, it must be solved.

H. N. EASON, chief of the division of income tax, Mississippi: Mr. Chairman: The adoption of a uniform formula for companies operating within and without two or more states is desirable chiefly because of the ease with which returns could be audited. In our law the commission has the fullest discretion in determining formulae to be used. We, in common with other states, want to be sure that we get our just share of the income which is realized. In an effort to do this the formula becomes complex and difficult of understanding. To me the solution would be for corporations of this class to state the book income realized from all operations, the adjusted federal taxable income and from this starting point the allocation of income or losses to the states in which the particular corporation operates. If the total income is allocated to states, I think that should suffice.

Of course, when a loss is sustained in one state a greater income would be allocated to other states than the income reported for federal income tax purposes. This would result also in the preparation of returns by the taxpayer being simplified. I believe that Mississippi would readily accept such a uniform formula.

The taxability of salaries received by employees of certain quasi-governmental agencies and organizations is one that has been quite a problem during the past few years. It is quite possible that this problem will be temporary. Mississippi holds that any grant by the federal government which is disbursed by the state is not exempt from a state income tax. We now have a case pending before the supreme court of the United States relative to the taxability of salaries paid employees of the Federal Land Bank. If this case is decided in the state's favor we plan to follow the same procedure in regard to salaries paid to the H.O.L.C. employees.

Our policy has been determined in some degree by the policy of other states imposing income taxes. It is to be regretted that court action was not developed and prosecuted vigorously two or three years ago. I am particularly anxious to know the policy of other states in this regard.

I am thoroughly wedded to the theory that no individual should be required to pay two state income taxes on the same income. In theory the allocation formula used by corporations precludes a corporation paying twice on the same income to a state.

In the Mississippi 1934 Income Tax Act we introduced a reciprocity exemption. We have arrived at an agreement with the state of Alabama that we will not tax a citizen of Alabama, regardless of the source of the income. They likewise do not tax citizens of Mississippi even though all the income is realized from within the state of Alabama. The loss in revenue is slight and it has brought about a great deal of correspondence between the two offices which in my opinion is most beneficial. I only wish that we could have the same agreement with every state in the union which imposes a state income tax.

The state of Iowa, for instance, taxes only citizens of Iowa. I do not subscribe to this theory for the reason that a citizen of a state which does not impose a state income tax should be subject to a tax on income arising, or income realized from business operations or property owned within the state which levies a tax.

This in brief presents my attitude in regard to these three questions. I am glad that they will be the subject of the discussions to be held.

Mississippi has had an income tax since 1912 and I regret to say that our administration is not one which gives us any great degree of satisfaction. We are continuously striving to improve the manner in which we discharge our responsibility, and I think that the round table proposed will be of great help to every state which has a representative present.

After more or less informal discussion it was decided that the presiding officer appoint a committee to prepare a resolution to be submitted to the resolutions committee of the conference. The presiding officer accordingly appointed as such committee A. J. Maxwell, North Carolina, Harry E. Boyle, Minnesota, and C. S. Lamb, Pennsylvania.

A. J. Maxwell, commissioner of revenue for North Carolina, presented the following paper:

TAXATION; FEDERAL INSTRUMENTALITIES; NATURE OF THE TAX UPON, NATURE OF ACTIVITY

Several problems involving the taxability of federal instrumentalities are now pending in the office. In a brief by Mr. Allen issue is taken with our ruling that the salary of an employee of a joint stock land bank is subject to state income taxation. Mr. Powell, of the unemployment compensation commission, has asked whether national banks and insurance companies, which have come within

the provisions of the *Federal Home Loan Banking Act*, are exempt from the provisions of the unemployment compensation act. The answer to these questions does not involve the same legal principles; however, I shall attempt to touch upon each of them.

1. CHARACTER OF THE TAX AS AFFECTING THE RIGHT OF
ONE SOVEREIGN TO IMPOSE BURDENS UPON
THE ACTIVITIES OF ANOTHER

Basing his conclusion upon the premise that "the power to tax is the power to destroy," Chief Justice Marshall, in *McCulloch vs. Maryland*, 4 Wheat. 316, ruled that the state had no right to impose any tax burden, however small, upon an agency properly adopted by the federal government to carry out the activities imposed upon it by the constitution. Soon the converse of the rule was announced so as to prohibit the federal government from taxing any instrumentality of the state. In *Buffington vs. Day*, 20 L. Ed. 122, it was held that the United States could not impose an income tax upon the salary of a state judge.

Marshall himself must have realized the difficulty involved in a literal application of the rule which he expressed, for in *Brown vs. Maryland*, 12 Wheat. 419, 441, he stated:

"The constitutional prohibition on the states to lay a duty on imports, a prohibition which a vast majority of them must feel an interest in preserving, may certainly come in conflict with their acknowledged power to tax persons, and property within their territory. The power, and the restriction upon it, though quite distinguishable when they do not approach each other, may yet, like the intervening colours between white and black, approach so nearly as to perplex the understanding, as colours perplex the vision in marking the distinction between them. Yet the distinction exists, and must be marked as the cases arise. Till they do arise, it might be premature to state any rule as being universal in its application."

At any rate, it soon came to be realized that the prohibition of every form of tax which affected an agency of government either directly or indirectly withdrew numerous enterprises that were properly sources of revenue. Two trends, the effect of which have been to impose limitations upon the original rule, have developed. The first of these is that expressed in *South Carolina vs. United States*, 199 U. S. 439, while the second is indirect taxation of governmental instrumentalities.

In *South Carolina vs. United States*, supra, the question involved was whether a federal license tax upon liquor stores applied to those stores which were being operated by the state of South Carolina. The court, proceeding upon the theory that a state had no

right to avail itself of the immunity from taxation when it invaded a field which, at the time the constitution was adopted, constituted a private business, held that the tax could be collected from the state-owned stores. The court said:

"Looking, therefore, at the constitution in the light of the conditions surrounding at the time of its adoption, it is obvious that the framers in granting full power over license taxes to the national government meant that that power should be complete, and never thought that the states by extending their functions could practically destroy it."

This case serves as authority for the position that where a state goes outside the bounds of legitimate governmental activity and engages in an enterprise that is proprietary in its nature, it is subject to federal taxation in respect to that activity. *Indian Motor Cycle Co. vs. United States*, 75 L. Ed. 1277, 1281.

"Of course the reasons underlying the principle (of exemption) mark the limits of its range. Thus as to persons or corporations which serve as agencies of the government, national or state, and also have private property or engage in their own account in business for gain, it is well settled that the principle does not extend to their private property or private business, but only to their operations or acts as such agencies; and, in harmony with this view, it also has been held where a state departs from her usual governmental functions and 'engages in a business which is of a private nature' no immunity arises in respect of her own or her agent's operations in that business."

Numerous cases can be cited in support of this position, but it is not necessary to do so. It is of interest, however, to note that a literal application of the rule must necessarily result in no benefit to the states. As the federal government derives its authority from the constitution, which is a grant rather than a limitation of powers, any function in which it is permitted to engage must necessarily be governmental in its character. At the same time, the enlargement of its activities is restricting traditional limits of state taxation. To illustrate, one of the matters in which we are immediately interested is the right of an insurance company to evade taxation by qualifying as a member of the federal home owner's loan system.

Thus, the principle that arose out of the *South Carolina case* has recently come up for close scrutiny. Justice Stone, in a unanimous opinion in *United States vs. California*, 80 L. Ed. 567, 573, stated:

"The analogy of the constitutional immunity of state instrumentalities from federal taxation, on which respondent relies, is not illuminating. That immunity is implied from the nature

of our federal system and the relationship within it of state and national governments, and is equally a restriction on taxation by either of the instrumentalities of the other. Its nature requires that it be so construed as to allow to each government reasonable scope for its taxing powers, (see *Metcalf vs. Mitchell*, 269 U. S. 514,) which would be unduly curtailed if either by extending its activities could withdraw from the taxing power of the other subjects of taxation traditionally within it. *Helvering vs. Powers*, 293 U. S. 214; *Ohio vs. Helvering*, 292 U. S. 360; *South Carolina vs. United States*, 199 U. S. 437; see *Murray vs. Wilson Distilling Co.*, 213 U. S. 151, explaining *South Carolina vs. United States*, supra. Hence, we look to the activities in which the states have traditionally engaged as marking the boundary of the restriction upon the federal taxing power."

The idea expressed in this case has been approved in numerous law reviews (see 49 H. L. R. 1323, where it is said that the test is whether the sovereign power be engaged in an enterprise that is ordinarily taxable by the state). If we examine the South Carolina case which is used as authority for the doctrine of proprietary and governmental purposes, it can be seen that the court adopted no such rule, but rather followed that expressed by Justice Stone.

The second trend away from the rule stated in *McCulloch vs. Maryland* is along the line of indirect taxation. During the course of the supreme court's history, there has developed the principle that a state could levy taxes that affected the agencies of the federal government provided the taxes are non-discriminatory and the burden is not a direct one. In *Railroad Co. vs. Peniston*, 18 Wall. 5, at page 30, the court, in holding that a railroad organized for private gain, but incidentally serving as an aid to the federal government, was subject to state taxation, made this statement:

"While it is true that government cannot exercise its power of taxation so as to destroy the state governments, or embarrass their lawful action, it is equally true that the states may not levy taxes, the direct effect of which shall be to hinder the exercise of any powers which belong to the national government. The constitution contemplates that none of those powers may be restrained by state legislation. But it is often a difficult question whether a tax imposed by a state does, in fact, invade the domain of the general government, or interfere with its operations to such an extent, or in such a manner, as to render it unwarranted. It cannot be that a state tax which remotely affects the efficient exercise of a federal power is for that reason alone inhibited by the constitution. To hold that would be to deny to the states all power to tax persons or property."

Again, in the more recent case of *Willcuts vs. Bunn*, 75 L. Ed. 304, 307 (holding that a federal income tax was applicable to profits derived from the sale of municipal bonds):

"The limitation of this principle to its appropriate applications is also important to the successful working of our governmental system. The power to tax is no less essential than the power to borrow money, and, in preserving the latter, it is not necessary to cripple the former by extending the constitutional exemption from taxation to those subjects which fall within the general application of non-discriminatory laws, and where no direct burden is laid upon the governmental instrumentality and there is only a remote, if any, influence upon the exercise of the functions of government. This distinction has had abundant illustration." (Here follows many citations.)

41 Y. L. J. 1237. "The way to the final step in this direction was suggested by Mr. Justice Brandeis in his separate opinion in *Burnet vs. Colorado Oil & Gas Co.* He pointed out that the validity of a given tax depends not upon a proposition of law, but wholly upon the determination of the fact whether, in the particular instance, an objectionable burden is imposed upon the execution of a governmental function—and questions of fact need not be fettered by *stare decisis*."

The books are full of cases illustrating the trend away from the rule that no burden whatsoever may be placed upon a federal instrumentality. The best examples occur in cases dealing with the taxation of ownership of securities. While it is unnecessary to discuss these in detail, a reference to them may be helpful.

81 U. Pa. L. R. 256, *et seq.*

It is only fair to point out that the rule permitting the indirect taxation of a governmental instrumentality is subject to qualification. In the first place, the tax must be nondiscriminatory (*McCallen Co. vs. Mass.*, 73 L. Ed. 847). In the second place, it must clearly appear that the burden is actually remote. Failure of proof of this fact sometimes results in decisions, the effect of which seems to be to go back to the rule as originally expressed. This explains decisions such as *Johnson vs. Maryland*, 65 L. Ed. 126, wherein it is stated at page 128:

"With regard to taxation, no matter how reasonable, or how universal and undiscriminating, the state's inability to interfere has been regarded as established since *McCulloch vs. Maryland*, 4 Wheat. 316. The decision in that case is not put upon any consideration of degree, but upon the entire absence of power on the part of the states to touch, in that way, at least, the instrumentalities of the United States, and that is the law today."

The third qualification of the rule is not really a restriction at all, but rather is a logical extension of the rule itself. It is that the constitutionality of the tax depends not only upon the remoteness of the burden which it imposes, but also upon the nature of the instrumentality sought to be taxed. *Metcalf vs. Mitchell*, 70 L. Ed. 384, 392:

“While it is evident that in one aspect the extent of the exemption must finally depend upon the effect of the tax upon the functions of the government alleged to be affected by it, still the nature of the governmental agencies or the mode of their constitution may not be disregarded in passing on the question of tax exemption; for it is obvious that an agency may be of such a character or so intimately connected with the exercise of a power or the performance of a duty by the one government, that any taxation of it by the other would be such a direct interference with the functions of the government itself as to be plainly beyond the taxing power.”

With these general principles before us, we now pass to a consideration of the exact problem before us; to wit, whether a state may impose a tax upon the income of an employee of a joint stock land bank, assuming for the moment that the bank is a federal instrumentality. The only case directly in point that I have been able to uncover is *Miller vs. McCaughn*, 22 F. 2d, 165. There, the federal government sought to impose a tax upon a regularly employed auditor of a state court. He received his compensation not from the state, but from corporate surety companies whose securities he approved. The court dispensed with the contention that the determining feature of the case was whether the taxpayer was a state employee by saying:

“There are two thoughts. One, the thought of compensation for services; the other, that of the recipient being a state officer or employee. The proposition advanced has some support in the verbiage of the statute, but not, we think, in its fair meaning. The compensation must not merely come to a state officer or employee, but it must come to him from the state, to be exempt. Unless this second line is drawn, and drawn where we have drawn it, it is difficult to determine where it should be drawn. A moment's thought will bring to mind scores of instances in which the recipient might well be held to be such ‘officer or employee’ but in which the compensation does not come directly or indirectly from the state, otherwise, than in the sense that he would not be in the enjoyment of it were it not for the relation of officer or employee of the state which he enjoys.”

While the supreme court has never had before it a situation of this type, it seems to me that the *McCaughn* case is perfectly sound. The result expressed there follows inevitably from the view now generally recognized that a tax must constitute a substantial interference with a governmental instrumentality before it will be declared invalid. Thus, in my opinion, we are correct in adhering to our contention in spite of Mr. Allen's brief.

2. CHARACTER OF BUSINESS AS AFFECTING NATURE OF INSTRUMENTALITY

It is extremely difficult to formulate any general principles to be used in determining whether a particular corporation or enterprise constitutes a federal instrumentality. In general, however, it may be said that an organization designed and operated primarily for the benefit of its stockholders is subject to state taxation, even though it may be engaged in performing an incidental service for the government. This principle was raised in *Osborn vs. Bank*, 9 Wheat. 738, 859, where the argument was made that the bank was taxable because it was organized for private profit and that the business which it did for the United States was incidental to its chief purpose. The court dispensed with the contention by showing that the bank was organized and operated for the purpose of carrying out the government's fiscal policy; however, in commenting upon this distinction, Chief Justice Marshall said:

"If these premises were true, the conclusion drawn from them would be inevitable. This mere private corporation, engaged in its own business, with its own views, would certainly be subject to the taxing power of the state, as any individual would be; and the casual circumstance of its being employed by the government in the transaction of its fiscal affairs, would no more exempt its private business from the operation of that power, than it would exempt the private business of any individual employed in the same manner."

The converse of this situation is also often presented. In the recent case of *Rogers vs. Graves*, 81 L. Ed. 202, the state of New York attempted to impose an income tax upon the salary of the general counsel for the Panama Canal Railroad Company, a company engaged in operating a railroad in connection with the canal.

Its stock was owned entirely by the United States government. The company was operated for the benefit of the government, but incidentally carried private passengers and goods for hire. The court held that the company was a federal instrumentality, saying on page 206:

"We attach no importance to the fact that the railroad company has utilized both its ships and railroad to carry private

freight and passengers. The record shows that this is done to a limited extent compared with the government business, and that it is only incidental to the governmental operations. The primary purpose of the enterprise being legitimately governmental, its incidental use for private purposes affords no ground for objection."

The *Fleet Corporation* cases and *Clallam County vs. United States*, 68 L. Ed. 328, were decided upon the same principle. In the Clallam case, a county levied a property tax upon the property of the Spruce Production Co., a corporation organized to furnish the government with war supplies. It was controlled entirely by the government. The county contended that taxation of the property of a federal instrumentality was not taxation of the means of the government. The court stated:

"We agree that it is 'not always, or generally, taxation of the means,' as was said by Chief Justice Chase in *Thompson vs. Union P. R. Co.*, 9 Wall, 579. But it may be, and, in our opinion, clearly is, when, as here, not only the agent was created, but all the agent's property was acquired and used for the sole purpose of producing a weapon for the war. This is not like the case of a corporation having its own purposes as well as those of the United States, and interested in profit on its own account."

We do not have to rely entirely upon any such generalities as this in determining whether joint stock land banks are federal instrumentalities. In the recent case of *Federal Land Bank vs. Priddy*, 79 L. Ed. 1408, Justice Stone ruled that these banks were not federal instrumentalities when he said on page 1412:

"Joint stock land banks are privately owned corporations, organized for profit to their stockholders through the business of making loans on farm mortgages. #16. There is nothing in their organization and powers to suggest that they are government instrumentalities."

It is true that this language constitutes dicta and is contrary to the intimation expressed in *Smith vs. Kansas City Title & Trust Co.*, 65 L. Ed. 577. There the court discussed the organization of both joint stock and federal land banks and decided that the latter constituted federal instrumentalities, but nowhere did the court say that a joint stock bank was such an instrumentality. In fact nowhere in the opinions of the supreme court can there be found any statement contrary to that of Justice Stone.

In connection with the Jefferson Standard Insurance inquiry, we have a slightly different problem to consider. Section 19 (7) of the unemployment compensation act exempts

“services performed in the employ of any other state or its political subdivision, or of the United States government, or of any instrumentality, or any other state or states, or their political subdivision, or of the United States.”

In view of this exemption, all federal instrumentalities are exempted from payment of the tax, even though it might be paid by the agency rather than by the government itself. The statute specifically relieves them of this liability.

It seems clear to me, however, that the Jefferson Standard Insurance Company did not become a federal instrumentality when it became a member of the federal home loan banking system. An examination of the act discloses that any insurance company organized under the laws of the state and dealing in home mortgage loans may become a member by subscribing to stock in a federal home loan bank. Section 4 of the act (12 U. S. C. A. 1424) requires that the insurance company be subject to regulation and inspection under the banking laws “or under similar laws,” but subsection (c) of this section relieves them of this qualification by stating that an insurance company not subject to such laws may become eligible by subjecting itself to the regulation of the farm loan board.

With the exception as to the amount of stock in the home loan bank that each member must subscribe and the provision against the charging of usury upon its loans, there are virtually no limitations placed upon the activities of the members of the system. The only provision that imposes any duty upon them, or trust in them by the federal government is found in the Home Owner's Loan Act of 1933, which establishes the home owner's loan corporation and federal savings and loan associations. Section 5 of this act (12 U. S. C. A. 1464) provides that members of the home loan banking system could, upon a vote of a majority of the stockholders, become federal savings and loan associations and that both the members of the home loan banks and the federal savings and loan associations might be designated as fiscal agents for the United States government. The supreme court in *Hopkins Savings Association vs. Cleary*, 296 U. S. 315, held that congress has no right to authorize the change of a state corporation into a federal one without the consent of the state; thus the provision was declared invalid. The subsequent portion of the section designating members of the home loan banks as fiscal agents for the government has not yet been tested. Assuming, however, that it is valid, it is my opinion that this provision and the few that are in the home loan banking act are not sufficient to convert the Jefferson Standard Life Insurance Company into a federal instrumentality. When its purposes and other functions are considered, it becomes apparent that the services which it performs or may be called upon to perform for the federal government are entirely incidental. It has

already been shown that this is not enough to justify its being deemed a federal instrumentality.

In this connection, the *Cleary case*, *supra*, is worthy of study. It intimates that in the absence of consent on the part of the state, congress has no right to alter the inherent character of a corporation organized under state law.

* * * * *

A keen interest was taken in the discussion of remarks and papers submitted by the invited participants by many of the delegates present and valuable ideas expressed. It is unfortunate that the round table did not have the benefit of a reporter in order that the worthwhile thoughts expressed by the numerous participants might be recorded in the *Proceedings*. The round table was by far the most interesting held at any National Tax Conference, both in point of number in attendance and in the interest manifested.

The entire afternoon having been spent in discussing income tax problems, upon motion the meeting adjourned.

EXPENDITURE AND BUDGET CONTROL

Presiding Officer—NORMAN MACDONALD,
Executive Secretary, Massachusetts Federation
of Taxpayers Associations.

Digest of discussions prepared by DENZEL C. CLINE,
Department of Economics, Princeton University.

DR. GEORGE A. SHIPMAN, research associate, Princeton Local Government Survey, Princeton University:

CONTROLLING PUBLIC EXPENDITURES THROUGH THE PUBLIC UNDERSTANDING OF THE PROCESSES OF GOVERNMENT

The problem is essentially that of obtaining an effective understanding of the processes of government—that is, an understanding which creates an atmosphere in which the citizen can act. The tool of understanding is education whether by direct instruction or by publication. In either instance, the requirements of presentation are essentially the same. The standards for effective publication of the results of inquiry into public problems provide a convenient illustration.

The medium of publication must reach its audience. For different levels of interest and action different mediums usually are necessary. There results a hierarchy of publications made up of posters, pamphlets, research reports, technical memoranda and legislative memoranda, each one fitted to the particular levels of interest, and

to the capacity for action that each level possesses. The most effective level for public education is probably the "key group" of citizens who supply leadership in public affairs. This is the group which is best fitted to carry constructive changes into effect.

The publication must also be understandable. It must be gaited to produce in the reader's mind the understanding that the investigator has obtained. It is no easy task to put technical problems into understandable terms. Not every individual can write such a report, least of all not every research worker. It is a task that calls for the highest competence and greatest ingenuity for simple and accurate statement. The presentation need not be discursive to be plain, lengthy to be impressive, nor descend to the vernacular to be familiar to the reader. It should be concise, straight-forward, simple and exact. The presentation must be vivid and impressive. Modern techniques of advertising and publicity are entirely legitimate when honestly and accurately applied. The use of colors, special formats, charts, graphs and other unusual methods of presentation can accomplish a directness and accuracy of expression that the printed word alone can not approach.

The method of presentation must first be analytical. Mere facts can be barren, lifeless and meaningless things, and occasionally their statement is an apology for failure or inability to think about them. Often a publication prides itself upon the presentation of "just the facts of the situation," although selection of data necessarily involves some notion of values, importance and meaning. If the investigation has any genuine value it has used a systematic method of analysis to determine the meaning of the data. This meaning should be the core of the presentation.

In the second place, the method of presentation should be interpretative. The ability of the citizen to act upon a government issue rests largely upon the interpretation of the meaning of a public problem. By interpretation the meaning is brought within the grasp of the reader. Consequently, the citizen group which is to act in its own behalf must be equipped with a presentation of the problems before it that interprets these problems in terms that permit each citizen to evaluate the alternatives of action confronting him. Interpretation emerges from a careful and exact statement of a definite and practical course of action.

In addition the point — the conclusion — must be demonstrated. Demonstration is the means whereby the citizen can be convinced that information and advice have some practical meaning in the current affairs of government. If the citizen is to act he needs the tools of action—such as a revised budget, an accounting system, an ordinance or possibly even a statute. When the citizen is equipped with clear-cut analyses, understandable interpretation and practical tools for action, he is armed to act effectively upon public issues.

GUSTAVE A. MOE, chief, field staff, Public Administration Service, Chicago:

The problem of expenditure control is constantly becoming more complex as a consequence of the encroachment of the federal government on the states, and by the states upon local government. Why do we want budget control? There are four principle purposes to be achieved:

1. A budget is for the use of the legislative body in deciding the advisability of spending. This is essential to keep the expenditures within available revenues, but few people really know when a budget is in balance.

2. Budget control is necessary to fix responsibility upon the persons who are going to spend the money. This also is essential, but it is not an easy matter to achieve.

3. It is necessary to obtain accountability for the money spent. We need to set up cost standards against which to check performance and to assist in getting proper types of expenditure programs.

4. Budget control is needed as a check or measure of the ability of the man or the person who spends the money.

The basic purpose of public reporting is to give the public a correct picture of what government is trying to do. To do this adequate financial statistics are essential. In our work for the New York state commission investigating the educational system, we found that the accounting system in use in school districts often was such that the necessary statistics of costs could not be obtained. In some instances it was necessary to install an improved accounting system as the first step in obtaining adequate information.

WALTER R. DARBY, state auditor of New Jersey:

For twenty years my job in New Jersey has required me to live with this problem. In a speech made when I first took office, I said, "I regard at least 80 per cent of my work to be education." That statement I would still make today, except that the percentage probably should be higher. New Jersey is one of the prime home rule states, and consequently we have not gone beyond the point of trying to educate local officials in budget-making. We have no control over general expenditures, except in an advisory manner. We do have control over mandatory appropriations or expenditures required by law. The state auditor has power to order the inclusion in local budgets of appropriations for debt service and deficits. Formerly there was great opposition, but by not wielding the big stick, that attitude has been changed. In 1936 the budget act was revised without any concerted opposition, although it gave the state auditor more power. Under the 1917 budget act he had no control over revenues or anticipated miscellaneous revenues, but this was changed in 1936. All county and municipal budgets now must have

the approval of the state auditor as to form and content, but he still has no control over general expenditures.

Competent financial reports are essential for supervision. The 1917 act required an annual audit of accounts. There are three very different aspects of reporting:

1. There is the report of audit. Of necessity this is a technical document, and one must be able to read a balance sheet to understand it.

2. There is the statistical report. This need not be as complete or as technical as the audit.

3. There is the report for the taxpayer and private citizen. It should be one that the average citizen can understand but it is a difficult job to make it so simple.

WILLIAM J. CASEY, chairman of the Commission of Economy and Efficiency of Baltimore:

Budget control and expenditure control are going to be determined under the methods used in financial administration. How would you install a central purchasing system? A personnel system? A proper accounting system? These are some of the problems our commission faced in Baltimore. When I began work with the commission in 1923 I asked for a balance sheet of the city of Baltimore, and was told that there was none. We were told that the city did not need one because it was not like a business run for profit!

We undertook a survey of the city government, one part of which was an accounting survey and the other an engineering survey. We found 45 city departments and 45 separate payrolls. There were many separate revenue billing and collecting departments. We first installed a central payroll system. There were about 12,000 city employees and a total payroll of some \$14,000,000. There were 130 employees partially engaged in the work of paying the others twice monthly. Under the new plan this work was done by a staff of 23 people and the checks were all audited before they were given out. There was also created a central bureau of disbursements which immediately encumbers the proper appropriation when a commitment is made.

As a result of our survey a central stores system was created. Formerly it had cost the city of Baltimore \$95 per \$1,000 of materials purchased to receive, store, and distribute the goods. That cost was brought down to \$56.

In 1930 there was a change in the organization of our commission. There was created a new independent body with no official relation to the city government. It has between 300 and 400 subscribers and a budget of about \$17,000 a year. The commission began a study of the city's debt. When the board of estimate sprung

a plan for a program that would have increased the debt \$63,000,000, we had our study ready to show where the city stood. It was shown that in 1937 the city would have had to pay \$12,000,000 for debt service. As a result there was public revulsion against that program and only \$7,500,000 of bonds were issued and these were for the water system—a self-sustaining enterprise.

We have made studies of street paving, the incineration of garbage, tax collector's reports, and various other subjects. Expenditure control will not be achieved by talking in generalities. There must be some agency to study specific problems and show concretely how economies can be obtained.

SALES AND USE TAXES

Presiding officer, DIXWELL L. PIERCE,

Secretary, State Board of Equalization, California *

At the opening of the discussion, the presiding officer explained that the invited participants had been asked to prepare brief papers devoted to legal and administrative problems encountered in the actual operation of sales and use taxes. Particular emphasis was placed upon a comparatively new form of taxation—the “use tax”—adopted by half of the states imposing taxes measured by the volume of local retail sales.

Thus, the discussion began with a paper by R. G. Sharpe, assistant attorney general, state of Washington, on “Legal Problems Incident to State ‘Use’ Taxes.” Explaining that pressure of work incident upon important litigation involving the validity of railroad tax assessments in Washington had prevented Mr. Sharpe from attending, the presiding officer read the paper which had been prepared by the assistant state attorney general.

R. G. SHARPE: Earlier controlling supreme court decisions defining the limitations of the commerce clause on the states' power to license or tax interstate activities in the main grew out of attempts by certain states to favor local merchants or manufacturers by discriminatory license and tax burdens upon those soliciting orders for interstate delivery. But in more recent years, as various states have attempted to shift a portion of the tax burden from property to business, measuring the levy by sales or volume of trade, the commerce clause, at first used simply as a shield to protect interstate commerce from discriminatory state legislation, has come to be used more as a sword to compel complete exemption of subjects of interstate commerce from all state excise taxation, whether discriminatory or otherwise.

The situation is thus well stated by Professor Roger J. Traynor, of the school of jurisprudence, University of California:

* Digest of proceedings prepared by presiding officer.

"The commerce clause of the federal constitution has served the development of interstate commerce long and well. The security of such commerce is now as firmly established as the unity of the nation, yet its special privileges continue even though the original reasons for them have disappeared.

The tables are now turned, with domestic commerce in the less secure position. All losses of local business to outside competitors result in losses of revenue not recouped by other states, for the corresponding gains to interstate business escape taxation altogether. More serious, however, is the permanent impairment of local business, at best, only partially counterbalanced by increased orders from other states.

The rapid development of state sales taxation has rendered a serious situation critical, and the need for a remedy has become urgent. If the state sales taxation is to continue, the states must find some way of equalizing the competition which now threatens their sources of revenue as it threatens their local businesses."¹

In enacting a 2% retail sales tax law in 1935, the Washington legislature, with perhaps some misgivings, attempted to prevent this subsidization of interstate sales by providing in the same revenue measure for a so-called "compensating tax," exacted for the privilege of using within the state chattels wherever purchased.

Litigation soon followed to restrain collection of this "use" tax as to property brought into Washington from Oregon. Notwithstanding the charge, among other things, that the tax unlawfully burdened interstate commerce, the act was sustained when the case reached the state supreme court.²

Other attacks were made on the law in the federal courts, and one of these suits has recently been decided by the United States Supreme Court. In that case, a construction company working on the Grand Coulee dam, brought into Washington property which was used in the performance of that work. After an adverse ruling in the district court,³ the supreme court, speaking through Mr. Justice Cardozo, upheld the law.⁴

In practical effect, said the court, the compensating tax helps retailers in Washington to compete upon terms of equality with dealers in other states, and tends to avoid a drain on Washington revenues through orders placed in other states to escape taxes on local sales.

The privilege of use was held to be only one of the attributes of property ownership, and a state is at liberty to tax all these attri-

¹ 24 California Law Review 175.

² Vancouver Oil Co. v. Henneford, 183 Wash. 317, 49 Pac. (2d) 14.

³ Silas Mason Co. v. Henneford, 15 Fed. Supp. 958.

⁴ Henneford v. Silas Mason Co., 300 U. S. 577.

butes collectively or separately. Thus, the fact that the exaction on the use may be called an excise does not impair its validity under the commerce clause.

Motives leading to its adoption can seldom, if ever, invalidate a tax which, apart from motives, would be recognized as lawful, and "least of all," said the court, "will they be permitted to accomplish that result when equality and not preference is the end to be achieved."

While this decision seems to give definite assurance that comparable use taxes, which the sales tax states have enacted for the protection of their revenues and the trade of their local merchants, will be sustained, there remains another important legal problem which has not yet been passed upon by the supreme court. This is the validity of a use tax applied to chattels brought into the state for use as a part of interstate instrumentalities such as railroads and telephone systems.

The question is squarely presented in a suit brought by an interstate railroad, which purchased, outside of Washington, tangible personalty transported into the state for use in operating, maintaining and repairing its lines. Following an adverse ruling below,⁵ the state has carried the matter to the United States Supreme Court, where it is shortly to be heard.⁶

It is hoped that the ultimate decision in this case will settle most, if not all, of the principal legal problems connected with the application of use taxes to interstate public utilities. Of prime importance is the problem of whether use taxes are sustainable when imposed after the interstate shipments have terminated, and before the personalty has become a part of an interstate instrumentality. Will the court conclude, as it has in similar cases,⁷ that there is sufficient "use" in the interval between these two events to warrant imposition of an excise by the state?

Or will the court find that there is actual interference with interstate commerce as it did in a case involving an excise on the use of gasoline which was in the fuel tank of an interstate ferryboat when the commodity entered the state attempting to impose the tax?⁸ It would seem that a use tax laid upon the first use after the interstate movement has ended and before actual use as a part of an interstate instrumentality has begun, would be distinguishable and would come within the rule of the cases mentioned earlier.

⁵ Northern Pacific Ry. Co. v. Henneford, 15 Fed. Supp. 302.

⁶ Henneford v. Northern Pacific Ry. Co., Cause No. 243, October Term 1937.

⁷ Eastern Air Transport, Inc. v. South Carolina Tax Com., 285 U. S. 147; Nashville, etc. Ry. Co. v. Wallace, 288 U. S. 249; Edelman v. Boeing Air Transport Inc., 289 U. S. 249.

⁸ Helson v. Kentucky, 279 U. S. 245.

There seems to be no particular cause for apprehension concerning one other legal problem connected with use taxes and not considered in the Washington taxes, namely: the validity of a requirement that retailers maintaining a place of business within the state, act as the state's agents for the collection of the tax. Such a provision appears to be sufficiently supported by a United States Supreme Court decision upholding an Iowa statute containing comparable provisions relating to gasoline taxes.⁹

Other difficulties will doubtless be encountered in connection with use taxes, but these are administrative, not legal, problems, and their solution must be left to the ingenuity of our good tax officials.

At the conclusion of Mr. Sharpe's paper, the presiding officer explained that the "Administration of Colorado's Sales, Use and Service Taxes" would be discussed by Homer F. Bedford, state treasurer, instead of Tom L. Pollock, director of the sales tax division, as announced in the program.

HOMER F. BEDFORD: Originally enacted as a temporary relief measure in 1935, Colorado's sales tax was incorporated into the state constitution in 1936 by a large majority at the November election. The voters also prescribed that the net proceeds should be distributed as follows: 85% to the old age pension fund, to be allotted through legislative appropriations.

Before this distribution is made, the retailers are allowed 5% of the gross for their trouble in handling the tax which they pass on to the consumers and another 5% is deducted for administrative expenses. Thus, the net which is available for old age pensions and general fund expenditures represents 90% of the gross tax.

The increasing productivity of the 2% Colorado sales tax is demonstrated by comparison of the yield of \$323,988 in March, 1935, the first month of its operation, with the yield of \$637,166 in July, 1937. Collections for 1937 have shown a constant gain over those for the corresponding months of 1936, and the receipts represent approximately 25% of the entire state revenue. Only one other source yields greater revenue, the motor vehicle fuel tax, which contributes 30% to the total.

To meet one of the major problems which arose early in operation of the sales tax—avoidance through interstate commerce—the use tax was passed at a special legislative session in April, 1936. This has done much to protect Colorado merchants from unfair competition arising from business formerly done free of tax across state lines.

Before enactment of the use tax, it was regrettably common practice for residents to buy new automobiles and other merchandise in adjoining states in order to escape our sales tax. This tax avoid-

⁹ *Monamotor Oil Co. v. Johnson*, 292 U. S. 86.

ance is now curbed in that the use tax law requires payment of the same 2% tax after the personal property is brought into the state.

Many feel that, as it affects our business men and merchants, the use tax is the fairest tax we have. It gives merchants along the state's borders a chance to maintain their business status. As a semi-protective tax rather than a revenue producer, it will be most effective when it produces increased returns in the sales and service tax revenues—a result which is already noticeable.

Colorado's sales tax is further supplemented by a recently enacted service tax, imposed since May 15, 1937 under a law which expires on June 30, 1939. In effect, the act extends the 2% tax from sales of tangible personal property to sales of services. The state treasurer administers both taxes, making the two operate as one tax scheme, thereby avoiding duplication of burdens. The same office and field force handle both taxes and the same tokens and schedules are used.

Generally speaking, retail merchants have approved this extension of the tax base to include services, as the law brings professional men and others into the same category as retailers for tax purposes. Some difficulties have been encountered, particularly in the determination of what services are taxable. Many businesses on the borderline claim exemptions on the theory that they are rendering non-taxable services. Legislation may be required to clear up some of the questions; persistent education is the only solution for others. Because of the complicated features of the law, considerable time and effort have been involved in making it effective. It is estimated that about 24,000 persons will be required to make service tax returns each month.

In our sales tax division we have 28,511 accounts, of which 10,046 are within the metropolitan area of Denver. Of a total of 69 field men, 30 are working in the metropolitan area. Although we are allowed up to 5% for administrative expense, actual costs have averaged 3.5% of gross collections.

Food leads the list of groups of businesses bringing in sales tax revenue, with general merchandise a close second. Thus, the percentages run: food, 30%; general merchandise, 24%; automotive, 12%; apparel, 8%; unclassified retail, 7%; utilities, 7%; lumber and building materials, 4%; manufacturing, 3%; and miscellaneous sales, 2%.

In Colorado the sales tax has met little resistance. Doubtless, the reason for this is that the public realizes the necessity of providing for aged residents as well as those in distress, and regards the sales tax as the most practical method of meeting this need. Collection of the tax on small purchases is accomplished through the use of a token, valued at two mills. Resistance to the tax has disappeared, largely due to the fact, no doubt, that the proceeds are

returned directly to the people from a pension fund distributed to persons scattered throughout the state.

When Mr. Bedford had concluded his remarks, the presiding officer stated that Henry M. Powell, of the New York bar, had been invited to speak on the New York City sales tax from the standpoint of a counsel for taxpayers and also to discuss state sales taxes generally as they affected his clients.

HENRY M. POWELL: By emergency legislation passed in 1934, New York City was authorized to impose a sales tax. By subsequent legislation the tax so authorized has been extended from year to year, and, in pursuance of such state laws, the city has imposed, among other levies, a 2% tax on sales of tangible personal property and a 2% compensating tax on the use of personal property upon which no sales tax has been paid.

The adjacent six New England states, New Jersey, Pennsylvania and Delaware have no corresponding taxes, nor does the state of New York now impose any sales tax. While conditions that have brought about recent sales taxes are largely economic, political considerations have played their part, and in the city of New York to these factors we may add its geographic situation and financial importance. The imposition of a sales tax, as it may affect the flow of business between cities and adjacent states, may have contributed to the absence, or repeal, of sales tax laws in the states mentioned.

That the tax has been successful in New York from the standpoint of the revenue produced is demonstrated by the following figures for the three years since its enactment:

Sales Tax

from December 10, 1934 to June 30, 1937....\$112,294,799

Compensating Personal Property Tax

from January 1, 1935 to June 30, 1937.....\$ 1,166,112

In New York City, as in the states imposing sales taxes, perhaps the most important legal questions were raised by concerns doing interstate business. The most recent case decided by the New York courts involved the sales of cash registers by an Ohio corporation, with principal offices in that state but with a sales office in New York, where it kept a stock of goods. Some orders were filled from this stock and others were shipped directly from the Ohio factory. The court held that the special orders, filled by shipments from Ohio, were not taxable, since the contract was not consummated in New York City, although there was a dissent based upon the proposition that, since transfer of title and possession took place in New York City, the tax was unauthorized and that there was no discrimination against or burden on interstate commerce.¹⁰

¹⁰ National Cash Register Co. v. Taylor, 252 App. Div. 90.

Questions of priority in the payment of sales tax have also engaged the attention of the courts. In a recent case, the United States Supreme Court reversed a holding of the United States Circuit Court of Appeals to effect that the city is not entitled to priority in the settlement of the estate of a bankrupt vendor on the theory that the vendor was merely the city's agent for the collection of the tax from the vendee.¹¹ Thus, it seems pretty well established that the city sales tax is definitely a tax on the retailer, although it may be quite generally passed on to his customer.

Experience in New York City demonstrates that, by resorting to a sales tax, a large amount of revenue for emergency purposes may be quickly provided, with uniformity and stability, at the same time relieving other sources of revenue which appear unable to respond to further tax demands without serious economic disturbance.

Sales taxes have now been adopted by one-half of the states of the United States, and there is little doubt that there will be accession to this number. Assuming that the congress would find it expedient to do so, imposition of a federal sales tax, the states sharing in yield, would be opposed to our political philosophy of local self-government. This might be followed by gradual taking over of the major functions of our state tax systems until the central government would appropriate all the taxing functions of the modern fascist state.

Mr. Powell was followed by H. A. Rininsland, director of the retail sales and use tax, Iowa State Board of Assessment and Review, whose discussion was directed particularly to the subject of an excise tax upon the use of tangible personal property purchased for use within a state.

H. A. RININSLAND: There has been a marked trend in the United States during the past few years toward property tax relief through increasing the amount of revenue derived from indirect or special tax sources. The retail sales tax stands out as a practical means of raising substantial revenues in furtherance of this program.

Administrators of sales tax laws, now in effect in half of the states, are agreed, I am sure, that the principal factor contributing to inequality in the collection of these levies has been our inability to extend the tax to sales of tangible personal property sold in interstate commerce. Although this property is used or consumed within the state in the same manner as similar property, sold locally and subjected to the sales tax, the users or consumers have been relieved of any corresponding tax burdens. Under such conditions, we are not only placing an instrument of escape in the hands of the taxpayer, but we are contributing to unfair trade practices.

¹¹ New York City v. Goldstein, 81 L. Ed. Adv. Op. 263.

It is with acclaim that we turn for relief from inequality to a law which not only broadens the scope of the tax but places the seller in the state on equal footing with his out-of-state competitor or competitor within the state who makes an interstate sale. The use tax law, supplementing and fortifying sales tax acts, has met this need, so that now one-half of the states with sales taxes also have use taxes. Validity of these new laws seems to have been established by a recent United States Supreme Court decision upholding a statute of the state of Washington.¹²

Use tax laws in several states require collection of the tax by the seller at the time of sale and provide that sale of property for delivery within the state shall be *prima facie* evidence that such property was sold for use in the state. In so far as a seller who maintains a place of business in the state is concerned, enforcement of the law is comparatively simple but the most disturbing factor for most administrators is the reluctance displayed by many sellers who sell direct and maintain no place of business in the state. Most use tax laws place ultimate responsibility for the tax upon the user in the event the seller does not pay, although, as a practical matter, the cost of recourse to the user may be prohibitive.

In my opinion, little argument can be advanced against the philosophy and purpose of a use tax law in a state where a tax is being collected upon retail sales. The fact remains, however, that serious collection problems confront us in connection with out-of-state sellers and it should be our aim now to see what can be done to secure better results in such cases. There is one thought which I particularly desire to leave with you who are charged with administration of use tax laws. May we not be overlooking the fact that our citizens, who are the ultimate taxpayers, oftentimes display keen interest in uniform enforcement of laws as applied to all taxpayers?

Would it not follow naturally, since the individual is ultimately liable for the use tax, that he would rather pay the tax to his seller, thereby being relieved of the responsibility and attendant in convenience of reporting and paying the tax direct to the state? The reaction of individuals as well as retailers has convinced us that the average citizen, when he understands the true situation, is particularly concerned when he finds that an out-of-state firm is taking business away from local firms through tax avoidance.

It is not my intention to condemn direct selling organizations nor do I mean to criticize those who protect their interests by insisting upon their constitutional rights. But I hope to convey to this group our responsibility to effect a plan of collecting the use tax that will not only be orderly but will be equitable and satisfactory to the state, the consumer, and the seller. Assuming that we may anticipate an unfavorable reaction upon the purchaser where

¹² *Henneford v. Silas Mason Co.*, 300 U. S. 577.

the seller maintaining no place of business in the state disregards the provisions of the tax law, it would appear that we should have little difficulty in accomplishing our purpose. Our results, however, will be meager if we do not squarely face the problem or if we are content to collect what we can through the channels of least resistance.

When Mr. Rininsland had completed his discussion, the presiding officer announced that the next speaker would be A. J. Maxwell, commissioner of revenue of North Carolina.

A. J. MAXWELL: It has not been feasible for me to prepare a paper for the purposes of this discussion, so my remarks shall be directed briefly to certain phases of sales tax administration which I believe demand the attention of all of us engaged in that work. In the first place, I desire to stress the importance of an adequate field audit program. In the second place, I want to emphasize the necessity of prompt action in determining additional taxpayers' liability and to point out the inevitable embarrassment which arises from long deferred demands for payments in addition to those which are made by the taxpayer at the time of filing his returns.

When I was in California recently, I had an opportunity to observe what was being done there with respect to field audits and to talk to the men who are in charge of that work. I found that it has been their constant aim to make determinations of additional taxes as soon as possible and to effect these collections promptly. Obviously, the volume of work involved is such that it has not always been feasible to complete the audits promptly and, in some cases, two years or more have elapsed between the time of the original return and the time when the additional assessment is made.

More often than not, this delay is the source of trouble. First, because the taxpayers' records for such a long period back are not always readily available and the means for checking their accuracy are much more limited than they would have been earlier. Second, even assuming that a satisfactory audit can be made, the accumulation of unpaid taxes, if the taxpayer has been proceeding on a wrong theory, is often so large that he is utterly unable to make the payment when it is demanded. Third, even if the difficulties already mentioned may be obviated, the taxpayer has a definite feeling that he is paying for a "dead horse" and is much more irritated by the additional assessment than he would have been if the demand had been made more promptly.

It was interesting to learn that these observations which I had made in the course of our work in North Carolina were the same as those made by the sales tax authorities across the country in California. This goes to prove that human nature is much the

same after all and that in tax work we must always consider the human element, adapting our methods to sound business practice.

Naturally, none of us wants to be dilatory in making audits and advising taxpayers that we believe they owe the state more money. The difficulty arises from the fact that the available funds are usually so limited as to prevent us from maintaining auditing staffs which are adequate to care for the volume of our work. We must do the best we can with the resources at our command. This means that care must be taken to map out a sound selective audit program, avoiding waste of time where no practical benefit would accrue from attempting a review of taxpayers' records.

I realize, of course, that we are expected to treat everyone alike and to show no partiality. This does not mean, however, that we should try to do the impossible and thoroughly audit every sales tax account at regular intervals. We should make audits where our common sense tells us that there would be some real point in doing so and these audits should be made so that additional tax liability may be ascertained promptly. Otherwise, we shall be confronted with the problem of large tax accruals on our books which we know are apt never to be fully collected because they have been allowed to go too long before the demands were made upon the taxpayers.

In closing, I want to repeat that, to my mind, a sales tax administration is only as good as its auditing program. A staff of good auditors, intelligently directed in a courteous but firm attitude toward the retailers paying the tax, is essential to successful sales tax administration.

After Mr. Maxwell's remarks, there followed a paper by Draper Allen, managing director of the Michigan State Board of Tax Administration, on the use tax, becoming effective in that state on November 1, 1937.

DRAPER ALLEN: All tangible personal property consumed or used in Michigan will be subject to a uniform tax regardless of where it was purchased and local merchants will be placed upon an equal competitive basis with those outside the state when our new use tax law is enforced. This form of taxation is comparatively new, yet has already been adopted by more than half of the sales tax states in the United States. It is not, strictly speaking, an additional tax but is supplemental to the sales tax and is designed to plug certain loopholes that had heretofore existed.

In common with other sales tax states, Michigan has been unable to extend the tax to transactions involving interstate or foreign shipments so that our merchants have been subjected to unfair competition. We believe that this condition will be corrected by our new use tax and estimate that it will yield approximately \$1,500,000 annually at the 3% rate.

Although like the sales tax in many respects, the use tax is equipped with sharper teeth. Thus, the maximum penalty for violation of the use tax is as much as \$5,000 in contrast to a \$1,000 maximum fine for sales tax violation. There are also severe punishments for any perjury involved in false returns. It is anticipated that the use tax will be particularly helpful in correcting unfair competitive conditions in such businesses as the supplying of building materials and related property. Hereafter contractors bringing materials or equipment into the state must declare the value of these articles and be liable for the 3% levy on their use, consumption or storage whereas, in the past, they have been able to bid for business in Michigan and complete the transaction without paying our tax.

Department stores, firms dealing in home furnishings, and similar enterprises will also feel the benefits of the new law. This is because those selling household articles and clothing by means of canvassers or direct mail order will now be subject to a tax at the same rate as the local concerns. Yet, the use tax is in no way discriminatory. It applies equally to all and merely prevents unfair avoidance of the burden imposed by the sales tax.

As in other states, the seller is expected to collect the use tax from the buyer and must add 3% to the purchase price at the time of the sale. The consumer's responsibility for the tax is not discharged, however, until the state has actually been paid, so that we can effect a collection from the buyer if the seller in another state ignores the tax collection. To prevent unnecessary hardship, consumers going to other states where they make purchases of small value are allowed to use not more than \$10 worth of merchandise thus brought into the state during a month without liability for the use tax.

An interesting phase of the new tax is that it will apply to municipally operated business enterprises which have heretofore been exempt from the sales tax by virtue of court rulings. It is estimated that a substantial amount of new revenue will be derived in this way.

In common with Washington, Michigan has incorporated a compensating feature in its use tax so that articles purchased in another state, subject to sales tax before they reach Michigan, will be exempt from our use tax provided the tax already paid is at the rate of 3% or greater. If the tax in the other state has been less than that amount, Michigan will collect a tax at a rate equal to the difference. This should insure absolute fairness in the operation of the law.

Administration of the use tax will be handled by the present sales tax staff and we do not anticipate that enlargement of the staff will be required, although some re-assignment of duties may be necessary.

Generally speaking, the machinery of administering the act will be substantially identical with that of the sales tax.

If it is possible for any tax to meet with popular approval, then it may be safely said that the use tax is likely to become Michigan's first popular and universally approved tax, because it was adopted primarily for the benefit and protection of Michigan merchants.

At the conclusion of Mr. Allen's paper, Oklahoma Consumers (Sales) Tax and Use Tax Acts were discussed by M. C. Connors, deputy tax commissioner of the state of Oklahoma.

M. C. CONNORS: Oklahoma has had a sales tax since July 10, 1933. The first law was passed as an emergency measure and expired by its own terms on June 30, 1935. In that year the legislature passed a consumers tax law with a slightly broadened base imposing a tax at the same rate, namely, 1%, but including in the scope a tax on certain utility operations, such as gas, electricity, telegraph, and telephone services. The rate of this tax was increased on July 7, 1936 when the voters approved a measure which provided that an additional 1% should be expended for the social security program. The additional tax would have expired by its own terms last June but the legislature renewed it until June 30, 1939.

In addition to the sales of tangible personal property and the utility services already mentioned, the tax applies to a number of specific services, such as the furnishing of rooms by hotels, advertising and printing, amusement businesses, and other related items. Certain items are exempt from the sales tax because of special excise taxes levied on their sale or use. These are motor vehicles, non-intoxicating beverages, cigarettes, and gasoline.

The most troublesome administrative problem we have is that of exemptions, a few of which may be mentioned as sales of raw farm products when sold on the farm by the producer, sales to churches, charitable organizations, the state and its political subdivisions.

Under the existing law, 3% of the yield from the tax may be used for administrative expense. This has made possible a definite program for developing an adequate sales tax staff.

In many ways the present act differs materially from the previous law. Thus, it provides that the tax shall apply to occasional sales rather than merely to sales by merchants; it provides for a tax on the rental of tangible personal property when such rentals result in a change of possession; it provides for a tax on receipts from coin-operated machines at places of amusement, and the like; it provides that where the tax liability does not exceed \$5 per month, quarterly reports may be made in lieu of monthly returns; protection is afforded to the state through a provision for jeopardy assess-

ments by the commission at any time when it appears that the tax may be lost through waiting until the time otherwise provided by law for filing a report.

At the outset there was a great deal of opposition to the sales tax, particularly from the merchants in our border counties, but a good deal of this has been overcome by the fact that there are now similar taxes in the adjoining states with the exception of Texas. We, who have the task of administering the law, now hear very few complaints from anyone other than the persons who are required to collect the tax and who sometimes contend that they have to do so without compensation. It should be observed, however, that the state has recently dispensed with other taxes that would ordinarily fall on these same merchants. When these facts are brought to their consideration much of the opposition is overcome.

At the 1937 session the legislature passed our use tax act which became effective May 6 last. This supplements the sales tax requiring the consumer or user in Oklahoma to pay the same amount of tax on an article purchased in another state and brought into Oklahoma for use as he would have been required to pay in the form of sales tax had the article been purchased in Oklahoma. It is my opinion that practically all states that have sales taxes will soon enact use tax acts, as it is almost imperative that such laws be passed for the protection of businesses within the sales tax states. There is apparently an overwhelming sentiment in favor of the use tax law in Oklahoma and I believe that the new act will have the effect of increasing sales tax revenue for the simple reason that the incentive to make purchases outside the state with a view of escaping the sales tax no longer exists. The principal purchases that will be made outside the state now for use in Oklahoma will be of those items that are not available in our own state.

It is estimated that our sales tax will yield in excess of \$11,000,000 during the current fiscal year. The use tax has not been in effect long enough to enable us to determine how much it will yield but our collections for last September were in excess of \$65,000.

It is impossible to administer properly and equitably a sales and use tax law without an adequate and competent field staff. As the Oklahoma Tax Commission collects all of the various forms of state taxes, all of its field work is now done by a general enforcement division, staffed by more than one hundred employees.

One of the most troublesome features of our law has been a provision to the effect that the tax should apply to the use of containers by the seller. Originally, the commission had ruled that containers sold to a retailer were not subject to tax because they would be resold by him along with the articles in connection with which they were used. The new provision, added in 1937, has

changed all this and now we are involved in considerable argument with various types of retailers on the subject of containers. What the eventual outcome will be, I shall not attempt to say.

The last of the invited participants to speak at the round table was John Curry, director of the sales tax department of the Alabama Tax Commission.

JOHN CURRY: Continued loss in revenue resulting from reduced property tax yields and the resultant plight of the school system brought about adoption of the sales tax in Alabama. In the face of strenuous opposition, the law was passed in November, 1936, and imposed a tax of one and a half percent on retail sales and amusements. Some of the opposition was met by providing that part of the proceeds should be used for replacing revenue lost by homestead exemptions.

This law became effective in January, 1937, but before two months had elapsed it was replaced by a new act, differing in many of its provisions, and levying a two percent tax on substantially the same transactions. This change, so closely following passage of the first act, produced inevitable confusion and our work was further complicated by a mandatory requirement for tokens which had to be supplied in short order.

Because passing the tax on to the consumer is made compulsory, the law should properly be termed a "Consumer's Retail Sales Tax." Sales of new automobiles are subject to a tax of one-half of one percent. Otherwise, the rate is uniformly two percent, but by reason of numerous exemptions, the law has been called the "Alabama Luxury Tax Act."

Not only are there exemptions of commodities subject to special excises, such as gasoline and tobacco, but also of many food products, used automobiles, textbooks, newspapers, fertilizers, seeds, farm products when sold by the producer, machinery used in processing, and other items too numerous to mention.

Two types of tax tokens are used. The commission has purchased forty million one-mill aluminum tokens and four million five-mill brass tokens. Although the commission may allow a five percent commission to merchants for collection of the tax, no use has been made of this provision.

Thus far the tax has produced an average of \$425,000 per month. This money is used first to replace revenues lost by exemption of homesteads not exceeding \$2,000 in assessed value, and the remainder is divided three-fourths to Alabama Special Education Trust Fund and one-fourth to the 67 counties for use in providing for health service, public welfare, and extension services in co-operation with the federal government.

There is also a provision for a use tax but so far we have been unable to accomplish much with this because of litigation question-

ing its validity. An appeal is pending before the state supreme court, after an adverse ruling to the effect that the provision is in conflict with a limitation on state advalorem taxes in our constitution.

Another section of the act levies a license tax on salesmen taking orders to be filled from stocks of goods located outside of the state. This license tax is based upon two percent of the value of the goods. Apparently, this exaction is also to be questioned as to its constitutionality so that it is impossible to forecast now what the results will be. Although designed to supplement the use tax, the claim is made that it goes further than the courts have allowed in interference with interstate or foreign commerce.

At the conclusion of Mr. Curry's remarks, the presiding officer expressed the gratitude of those attending for the helpful discussion provided by the participants, closing the conference with a short statement concerning experience with sales and use taxes in California.

DIXWELL L. PIERCE: Due to the lateness of the hour we must soon bring this session to an end, but before we do, I should like to review briefly some of our experiences in my own state which I believe may be of interest to you.

California first imposed a sales tax in August, 1933. Then the rate was $2\frac{1}{2}\%$ and the tax applied to practically all sales of tangible personal property at retail, with the one important exception of gasoline. There was no change in the law until July 1, 1935, and in the period of one year and eleven months, when the $2\frac{1}{2}\%$ rate was effective, the total collections were \$106,908,081.

Beginning with July 1, 1935, the rate was advanced to 3% but an exemption for foodstuffs was added, save as these might be sold in the form of meals at restaurants. It is estimated that this exemption reduced the tax base by at least 20% but the yield has continued to advance steadily. During the fiscal year ended June 30, 1936, the collections were \$73,064,256, and for the fiscal year ended June 30, 1937, the corresponding figure was \$88,340,831. It is confidently expected that the yield for the current fiscal year will exceed \$90,000,000.

We attribute our success in sales tax work in California to two major factors, namely, the efficacy of our field audit work and the support given to the tax through the adoption of the use tax in July, 1935. I heartily concur in what has been said by other speakers here today concerning the necessity for a use tax in a state which imposes a retail sales tax. In fact, we consider the use tax an integral part of our sales tax system and use the same reports for both levies. The revenue derived from it is included in the figures which I have given you.

The importance of taxpayer cooperation and adequate field work can not be overstated. Recognizing this at the outset, the California State Board of Equalization established thirteen district offices at strategic points throughout the state, using these as headquarters for its field staff. Branch offices have been added until there are now some thirty-five in all. The work of these is, of course, all correlated through supervision from the main office at the state capital.

There are more than 500 auditors and investigators on the sales tax staff with the preponderance in the auditing group. During the past fiscal year, some 27,000 audits were completed producing additional revenue in excess of \$3,000,000. At the same time every effort was made to see that the retailers were adequately informed as to the correct interpretation of the law and their cooperation was solicited toward correct reports in the future.

Notwithstanding the comparatively large staff which, with the inclusion of office force, totals approximately 1,000, the aggregate expense of our sales tax administration is less than $2\frac{1}{4}\%$ of the total collections. We are convinced that it is folly to attempt to save money by curtailing administrative expense to a point where field audits can not be made promptly, and in this connection we heartily concur in what has already been said by Mr. Maxwell of North Carolina. The nature of sales tax work is such that it requires constant vigilance on the part of the administration if the results are to be successful. Cheap sales tax enforcement will undoubtedly prove the most expensive in the long run.

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THIRD SESSION

MONDAY, OCTOBER 25, 1937, 8:00 P. M.

SIMEON E. LELAND (Illinois): Judge Zoercher reminds me that the time has now come when this session should begin. As a matter of fact, he has been sitting on the edge of his seat ever since the clock struck. I think I will be glad to entertain a motion that he be elected either time-keeper or watch-dog so that these sessions not only may start on time, but they will stop before bedtime. You know, one of the things that is of greatest interest to the Judge is not only that the sessions shall start when scheduled, but that they shall stop so they will not interfere with his dinner, or his lunch, or whatever else he happens to want to do as the clock reaches certain points.

We have this evening for discussion one of the most important and most interesting topics in the whole field of fiscal and tax policy. It is not my intention to make a speech, but only to talk long enough so that the people who are out in the hall will have a chance to get in.

The meeting will be turned over to our presiding officer, James L. Sayler, who has been a member of the National Tax Association for many, many years. I think the first conference I ever attended, so many years ago, was one at which he was present. As a matter of fact, upon inquiry I find that though he is not a charter member, he has been a member of the association for seventeen years, and is a regular attendant at the conferences. He needs, therefore, no introduction to you, and I am not turning this meeting over to him as an old-timer, but rather as one of our good and loyal members. He will run the show as he pleases. Mr. Sayler!

CHAIRMAN SAYLER: Mr. Leland, Members of the Conference, the first conference of the National Tax Association I attended was in the city of Chicago, my home. It was the first time that I had ever heard of it. I had become interested in taxation that year. I went down to the La Salle Hotel in Chicago. The first man I saw was Mr. Whitney, for many years an active member of the association, a representative of the Western Union Telegraph Company. I spoke to him. He said, "The first thing you want to do is join the National Tax Association," which I did the next year, and I have been a member since that time.

This social security legislation is a matter to which attention has been given at a few of the conferences. As I see it, the problems

revolve pretty much around three situations, one arising in connection with title 8 of the Federal Social Security Act, known as the old age pension system. The second is under title 9 of the act, which relates to unemployment insurance. The third, then, relates to the legislation which has taken place, I think, in every state of the union providing unemployment insurance as applied to various states.

I am not going into the technical and economic phases of it. Being new legislation, and forced as the federal government has been, and the states also, to define terms, and provide for a large number of accounting and similar situations, and being applicable to various types of business, it has been a tremendous task to write regulations and state the thing with clarity.

At the conference last year at Indianapolis there was a report of one committee on social security legislation. The conference last year did not request a continuance of that committee. But the executive committee of the National Tax Association, as it has the power to do, provided for a committee which has been studying the problem this year, and the committee report tonight will form the basis of the discussions.

I have not had much time to talk to Mr. Blough, of the University of Cincinnati, who is the chairman of the committee. He will make a report, partly from reading the committee report and partly from his own comments. I trust you will give serious consideration to this.

The ordinary rule is that papers shall be limited to twenty minutes, but on account of this situation here tonight, I think we should accord Mr. Blough some additional time.

Discussion ordinarily is limited to seven minutes, and I trust that those who take part in the discussion, when they arise, will state very plainly their full names and the states from which they come.

Before introducing Mr. Blough, I think Mr. Query has a few announcements to make.

SECRETARY W. G. QUERY: The entertainment committee requests me to announce that for the ladies the following program has been arranged: Tomorrow afternoon at one-thirty in the lobby of the Lord Baltimore Hotel, the ladies will gather and will board cars and buses for a sight-seeing trip around the city.

On Wednesday afternoon at one-thirty they will meet in the lobby of the Lord Baltimore Hotel to be taken to the Hippodrome Theater for a movie party.

Other announcements will be made tomorrow with respect to entertainment.

President Leser requested me to read the following letter from the president of the Baltimore City Rotary Club.

"MY DEAR JUDGE LESER:

"Will you kindly extend to the members of your association convening here a most cordial welcome to attend the regular luncheon meeting of this club on Tuesday, October 26, 12:15 noon, meeting in the Florentine Room, Lord Baltimore Hotel.

"If possible we should like to have a memorandum of the number who will visit with us so that proper accommodations may be made. This information can be telephoned to our club office, room 464, Lord Baltimore Hotel, by those expecting to attend."

HARLEY L. LUTZ (New Jersey): It has been suggested that your statement regarding the speakers be supplemented by saying that in addition to their full name they give their social security number.

CHAIRMAN SAYLER: I don't like to go into social security numbers, because I am past the age when I am entitled to any benefits. It is a kind of sore spot with me.

I take pleasure in presenting Roy Blough, University of Cincinnati, who will submit the report of the committee on social security legislation.

ROY BLOUGH (Ohio):

REPORT OF THE COMMITTEE ON SOCIAL SECURITY LEGISLATION AND ADMINISTRATION

ROY BLOUGH, CHAIRMAN

Department of Economics,
Graduate School of Public Administration,
University of Cincinnati

PURPOSE OF THE COMMITTEE'S REPORT

In this report your committee has built on and to some extent has repeated the report of last year's committee and has had the benefit of the other papers and discussions presented at the Indianapolis conference.

The program for promoting economic security incorporated in the social security act of 1935 is a far-reaching development in American public policy. It involves the redistribution of income, the imposition of charges on industry, forced savings by beneficiaries to meet the costs of old age and unemployment, and other matters that raise fundamental issues of social philosophy and go to the heart of our politico-economic order. Such basic problems involve matters beyond the concern of this committee, if we interpret correctly our assignment and the field of interest of the National Tax Association. We have proceeded on the assumption that this report should deal with the effects on government finance of the act and

of proposals to change it. The procedure followed by the committee has been to relate the provisions of the present act, together with proposals for change, to their probable fiscal results without any final conclusions as to the social desirability of the provisions.¹

Even within this somewhat narrowed field too little time has elapsed to give more than tentative opinions. The social security act is only two years old; unemployment compensation is being paid in only one state; old age benefits are not to be paid for more than four years. Accordingly, the committee can only attempt to forecast the results that seem most likely to occur. Actual results may be much different due either to the introduction of unexpected factors or the unexpected interaction of existing factors.

ESSENTIAL FEATURES OF THE PRESENT ACT

The provisions of the social security act of 1935 need not be stated in detail here, but the more important ones may perhaps be listed with profit.

1. Federal grants in aid to states are provided in three categories of public relief given to indigents.

In aid to the aged (65 years and older) and aid to the blind the federal government will pay one-half of the cost with a maximum federal grant of \$15 a month in any one case. In aid to dependent children the federal government will pay one-third. In each category state governments—as distinguished from local governments—are required to contribute at least part of the balance. The coverage must be statewide, and certain other requirements must also be met before the plan will be approved.

2. A federal system of old-age insurance or “benefits” is provided.

New taxes with respect to employment are imposed, one an income tax on workers, the other an excise tax on employers, both measured by payrolls and paid by the employers, who deduct the income tax from the workers' wages. The rates of both taxes are 1 per cent for the years 1937 through 1939, 1½ per cent for 1940 through 1942, 2 per cent for 1943 through 1945, 2½ per cent for 1946 through 1948, and 3 per cent beginning January 1, 1949. The taxes do not apply to compensation of more than \$3,000 in any year to any individual with respect to his employment by any employer, nor to remuneration of individuals 65 years of age and over. Agricultural labor; domestic service in a private home; casual labor; service performed for religious, charitable, scientific, literary and educational organizations: services performed for the United States or a state or political subdivision thereof; and service performed as an

¹ It would, of course, be quite erroneous to interpret the narrowing of the scope of the report in this manner as reflecting or implying opposition on our part to provision for economic security by governmental action.

officer or member of a crew of a vessel documented under the laws of the United States or any foreign country are all exempt from the tax.

Provision is made for a schedule of benefits varying in amounts up to \$85 a month, to begin at the age of 65 and continue for life. The amount of the monthly benefit is dependent on the total wage earnings subject to tax that were earned by the pensioner. The minimum total of payments guaranteed to the pensioner or his estate is $3\frac{1}{2}$ per cent of his earnings subject to tax. Persons do not accumulate rights to benefits while working in tax-exempt employment. An old-age reserve account is set up in the federal treasury into which congress is authorized but not required to pay amounts up to a full actuarial reserve for benefits. The funds in the account are to be held in the form of cash, federal securities already outstanding (if they can be purchased to yield 3 per cent), or specially issued obligations of the treasury. State and local governments have no functions to perform in the old-age benefits system.

3. Inducements are provided to create state unemployment compensation funds.

A federal tax with respect to employment is imposed on employers of 8 or more persons, the tax being 1 per cent of payrolls in 1936, 2 per cent in 1937, and 3 per cent thereafter. A credit for contributions made to an approved state unemployment compensation fund is allowed up to 90 per cent of the tax, the balance being paid into the general federal treasury. The federal government makes grants to the state to pay the cost of administering the state unemployment compensation system. An unemployment trust fund is set up in the treasury into which are paid all receipts of the state unemployment compensation funds, and from which are paid amounts requisitioned by the states with the approval of the social security board. The unemployment trust fund is to be invested in especially issued federal securities bearing approximately current market interest rates, or in outstanding federal securities.

A lack of unity is apparent in the three plans mentioned, which, however, may be more apparent than real. The public assistance programs are state created and administered, but states are stimulated and financially assisted by federal grants. The old-age benefits system is purely federal. The unemployment insurance systems are state created and administered, but state action is stimulated by a federal tax credit, the plans are approved by the federal government, the funds are held by it and the costs of administration paid by it.

In addition to these major elements in the social security ensemble there are minor provisions to finance and encourage public health, child welfare and other services. Because of the small amounts of funds involved and the absence of any important new principle, such provisions will not be discussed in this report.

PROBABLE FISCAL EFFECTS OF THE PRESENT ACT

In the following paragraphs an analysis is made of what appear to the committee to be the probable effects of the social security act of 1935 on federal, state, and local finance. Discussion is under the general headings of expenditures, taxes, debt, and inter-governmental fiscal relations.

A. EFFECTS ON GOVERNMENTAL EXPENDITURES

1. *Volume of expenditures.* The public assistance sections of the act add to the recognized functions of the federal government a continuing responsibility for the support of relief. The federal government admitted no such responsibility prior to the depression but since 1932 has appropriated heavily for general unemployment relief. While the effect of the social security act may be to reduce the amount of general, non-categorical relief needed, the net effect will undoubtedly be to increase permanently federal welfare expenditures in general. Two reasons appear for this conclusion. One is that the level of general relief before the social security act was ordinarily not so high as the level of public assistance payments by states that receive federal grants under the act. The other reason is that the federal government undoubtedly expected to withdraw from general relief when state and local finances improved,² while withdrawal from the social security public assistance grants is unlikely.

State and local expenditures for non-categorical relief are also undoubtedly being reduced by shifting a substantial part of the load to the public assistance categories. However, total expenditures for all welfare services combined are rising due to higher standards and more complete coverage. State and local contributions for the assistance categories are increasing despite the help of the federal subsidies. Only about half of the states had aid to the aged before the passage of the act while practically all do now, and levels of payments are continuing to rise. Similar situations prevail in the other types of aid. Practically all states nominally provided aid to dependent children prior to the passage of the act but levels were low and coverage far from universal.

The payroll taxes on employers of 8 or more will increase federal expenditures somewhat, since the federal government pays the cost of administering the state systems. Such administrative costs, however, will perhaps not exceed the 10 per cent of the tax received. The large trust receipts and expenditures for the unemployment trust fund should in the long run be burdensome to the federal government unless it creates a debt especially for the fund, and spends the fund's

² As evidenced in part by the transferral of its relief expenditures to a works program and its withdrawal from other relief.

receipts. However, the fluctuations in the unemployment trust fund receipts and payments due to prosperity and depression will intensify the problem of federal financial management, although the fluctuation in expenditures may be no greater than in relief expenditures without the system. State expenditures for unemployment compensation will, of course, be an addition to pre-act expenditure levels, since only Wisconsin had adopted an unemployment insurance system before the passage of the social security act. Expenditures will be much larger in depression than in prosperity periods, but the severity of the effects on the state budgets will be reduced since the funds are held in and paid from the federal treasury. However, if the compensation due the unemployed should exceed a state's balance in the trust fund, that state might add to its regular expenditures in order to pay the compensation rather than default on payments.³ Unemployment compensation payments permit a reduction in the general relief payments but in less amount since all unemployed and not merely the indigent receive unemployment compensation and since the standards of compensation will presumably be higher than standards of relief payments. Expenditures under public assistance categories will probably not be substantially reduced since they do not go to employable beneficiaries. Unemployment compensation may contribute to reducing indigency in the old age of the wage earner or at his death or disablement.

The old-age benefits system increases the expenditures of only the federal government, and the amount of the increase is small for the coming few years. Beginning in 1942, however, the payment of benefits will gradually increase until in 1980 it is expected to reach, under present statutory provisions, the probable level of \$3,000,000,000.⁴ The increase in payments under the old-age benefits or insurance plan will no doubt substantially decrease future payments by both federal and state governments for the old-age assistance (relief) program. However, the decreases will not equal the increases, since old-age benefits will go to others besides indigent aged. Furthermore, a large portion of the population does not come under the old-age benefit plan so that old-age assistance could not be replaced entirely.

A very important question that has caused considerable controversy concerns the effect on governmental expenditures of the collection of payroll taxes during the period of perhaps 30 years⁵

³ The federal act does not require such supplementation. To the extent that it takes place, unemployment compensation becomes a charge on general revenue.

⁴ According to estimates prepared by the Senate Committee on Finance, 74th Congress, 1st Session, Senate Calendar No. 661, Report No. 628, p. 9, quoted in Paul H. Douglas, *Social Security in the U. S.*, (New York, 1936), p. 167.

⁵ *Ibid.*

when such taxes exceed benefits. As previously indicated, these taxes are legally part of the general federal revenues and do not need to be paid into its old-age reserve account. If they are not paid into it they will be freely available for expenditures and will permit a larger level of expenditures without increasing the taxes or borrowing; likewise the same level of expenditures can be supported while other taxes or borrowing are reduced. The pressure of limited revenues to cause a balanced budget would not be present and higher expenditures than would otherwise exist might be expected. If future financial difficulties should occur similar to those that have existed in the recent past, it seems probable that in some years, perhaps frequently, less than the total of payroll taxes may be paid into the reserve account. If, however, as is usually anticipated, the payroll taxes are paid into the old-age reserve account, these results may occur: (1) the outstanding debt may be retired in the hands of the public, and the obligations transferred to the old-age reserve account, or the debt in the hands of the public may be prevented from growing as much as it otherwise would; (2) other taxes may be decreased, the debt in the hands of the public not being affected while the obligations in the reserve account increased; (3) expenditures may be increased, with the debt in the hands of the public not being affected and the debt to the reserve account increased.

It is possible that not one but all three of these results may occur together, that is, the debt in the hands of the public may be decreased somewhat, other taxes may be decreased somewhat, and expenditures may be increased somewhat. It seems almost certain that expenditures would be somewhat higher than they otherwise would be, since, while the obligations to the old-age reserve would appear on the treasury statement as a debt, the difficulties of floating the debt in the public markets, and the effects on interest rates, bank reserves and credits, and price levels would be absent. Thus those checks on increased debt that are probably most potent would be lacking. This is especially the case when direct obligations are issued to the account. The encouragement of a higher level of expenditures during the period when the reserve was being developed would lead to a higher level than could be maintained thereafter without higher general taxes, since the full burdens of the old-age benefits would then have to be met. A customary level of expenditures is difficult to reduce, as experience has shown, so that the result might very well be a permanently higher expenditure level with permanently higher taxes.

The encouragement to higher expenditure levels may be expected to be exceptionally strong in case the reserve grows so large as to absorb the total national debt. If the present level of debt were maintained without increase or decrease this would probably occur

between 1965 and 1970.⁶ Thereafter, either a huge cash surplus would pile up, or other taxes would be decreased or expenditures would be increased. Of course, this could be met by permitting the reserve fund to be invested in state and local and perhaps even industrial securities, although investing in the latter would raise serious questions of industrial control. In any case this date is sufficiently distant not to be highly important at the present time.

Even before the debt was paid off the requirement that federal obligations must yield 3 per cent would probably mean the issuance of special obligations with little pressure to use the funds to retire outstanding debt.

The accumulation of government obligations in the reserve account might in itself encourage governmental expenditures, perhaps for increased benefits, since, although not really assets to the government, the securities in the old-age reserve account would have the appearance of being such. This would be truer of bonds purchased on the market than of the special obligations. Whether more encouragement to a higher scale of benefits would result from the use of the old-age reserve account than from the use of other methods of financing old-age benefits is an important question, which will be discussed later under proposals for change.

2. *Distribution by types of expenditures.* The increased expenditures of state and local governments for purpose under the social security act probably have a tendency to decrease expenditures in other fields. The federal subsidies and tax pressures add to the relative desirability of expenditures in the fields immediately affected; the increased taxes, both federal and state, necessary to finance the increased expenditure in these fields, tend to raise the importance of the marginal dollar left to the individual. This tends to result in his voting to reduce expenditures in other fields whose absolute importance has not been affected but whose relative importance has declined in comparison both to expenditures under the social security act and to private expenditures.

In practice this means that the difficulties, both political and economic, of increasing the yield of total state and local taxes will probably result in part of the added social security expenditures being financed by reducing other types of expenditures. Evidence is already appearing—although of course the long-run effects cannot be demonstrated so soon—that in some states the increases in social security payments, especially for old-age assistance, are being accompanied by decreases in expenditures for other types of relief and for purposes entirely outside the assistance field, such as education.

The effects on the federal government, however, may for some years be the opposite since along with new functions the federal government receives new revenue that for a time may greatly exceed

⁶ *Ibid.*

the new expenditures. To the extent that expenditures are encouraged—as previously discussed—the encouragement extends to other fields than relief or welfare.

B. EFFECTS ON TAXES

(1) *Volume of revenue*

New taxes tend to reduce the yields of the old ones and this may be expected in the case of the payroll taxes. The state unemployment compensation taxes will likely reduce the yields of sales, income, and business taxes, although the payment of unemployment benefits should increase yields of sales taxes. The same reasoning applies to the payroll taxes for financing old-age benefits, although here the fact that a very long time elapses between the payment of the tax and the distribution of the benefit may mean, as previously discussed, that other statutory tax rates will be reduced or not increased, thus more or less offsetting the discouraging effects of payroll taxes on other tax yields.

To the extent that the payroll taxes reduce the yields of other taxes and are devoted to special purposes they make more difficult the financing of other governmental functions. Of course, if the payroll taxes are used to finance general functions, as they might be temporarily until benefit payments absorbed them, they should much more than offset the reduction in other tax yields that they cause.

(2) *Quality of the tax system*

A further question concerns the probable effects of the Social Security Act on the quality of tax systems. Any substantial increase in state and local expenditures is likely to increase the regressiveness of state and local tax systems. As is well known, states find it much more difficult than the federal government to employ progressive types of taxes; there are real if undefined upper limits to such taxation. The result is that when pressure for increased revenue is placed on states—as is the case with public assistance—they tend to make use either of additional property taxes or of excise and sales taxes. Because of the opposition that has developed to additional or even existing property taxation, the sales tax alternative is the one commonly taken.

The state taxes for unemployment compensation funds and the federal payroll taxes present a somewhat different problem. It is sometimes contended that these taxes should be considered insurance premiums and not taxes at all, and that they should not be included in considering the quality of the tax system. While there is much resemblance to insurance premiums, there is more to other taxes. This is especially true regarding the taxes for old-age benefits. The contribution is compulsory; the system is only quasi-contributory since the benefits are not in proportion to taxes with respect

to employment;⁷ the recipient is entitled to benefits whether or not the taxes on his employment were paid;⁸ the obligation of the government to the old age account is not conditioned by the realization of sufficient revenue; the employer's contributions are not dependent on the amount of labor depreciation his industry causes since the tax is the same whether workers depreciate so rapidly that they cannot be employed after 40 years of age or so slowly that they can work until 75; the high wage employer must in a sense subsidize the workers of the low wage employer, since the workers of the latter will receive in benefits part of the taxes paid by the former.⁹ Important also is the fact that the federal payroll taxes are not legally required to be devoted to any specific purposes. The tax on employers of 8 or more yields substantially more revenue than is required at the present time to pay the cost of administering the compensation systems.¹⁰ The payroll taxes with respect to employment may be used for general purposes without being placed in the old-age reserve at all. If they are placed in the old-age reserve account they are used, during the period of 25 years or so while the system is getting under way, to withdraw outstanding debt from private hands, or to reduce other taxes, or to increase expenditures,—all of which are general public purposes far removed from the analogy to insurance. The problem is primarily not an actuarial one of reserves against individual policies but a problem in governmental finance.¹¹ Contributions to state unemployment funds are probably much closer to insurance premiums than are the federal payroll taxes.

Since the payroll taxes may be a source of general revenue, it may be well to see how they meet some of the more important criteria of a good tax system. They are not markedly stable in revenue, being probably less stable than a general or retail sales tax but more stable than the net income taxes. They are probably moderately elastic. The income tax on wages promotes tax consciousness—if this be a virtue as many claim—among a large group that probably has had little consciousness of federal taxation in the past, while the excise tax on employers probably adds little to pre-

⁷ The monthly benefits are computed as the sum of $\frac{1}{2}$ of 1 per cent of the first \$3000 of taxable earnings received; $\frac{1}{12}$ of 1 per cent of the next \$42,000 and $\frac{1}{24}$ of 1 per cent of all over \$45,000. The person with small total earnings thus receives a larger proportionate benefit than one with large total earnings.

⁸ *Social Security in America*, p. 214.

⁹ See note 7 above.

¹⁰ Although in the future there is some reason to believe that the reverse may be true.

¹¹ Anonymous article in *Quarterly Journal of Economics*, May, 1937, p. 454.

existing tax consciousness. Difficult administrative problems appear inevitable in attempting to reach a multitude of small business units and in distinguishing taxable and non-taxable payrolls. The distribution of the burden of the taxes depends on its incidence. The incidence of the income tax is almost certainly on the workers and it appears probable that part of the employers' tax may also be. To the extent that the incidence is on the workers the taxes are slightly regressive in burden below the \$3,000 level, since wages constitute a somewhat larger share of the total income in the case of very small incomes than in the case of medium-sized incomes; and are very regressive for wages exceeding \$3,000, since the taxes do not apply to wages above that point. Workers over 65 and in exempt employments are favored at the expense of other workers. To the extent that the incidence of the taxes is on the consumers, being shifted to them as a cost of doing business, the burden is likely to be distributed regressively among consumers of the goods in question in the same manner as are sales taxes and business taxes other than those on incomes. If the taxes remain on the employer they are in effect a form of business tax with an erratically distributed burden. Industries or concerns employing workers over 65, or with salaries of over \$3000, or using relatively little labor are taxed more lightly than others.

Since the excise tax on employers is in the first instance at least, an addition to the cost of labor, the use of labor-saving machinery instead of labor is likely to be encouraged so long as the tax is not shifted to the workers.

The characteristics of the payroll tax on employers of 8 or more (unemployment compensation tax) resemble in many respects those of the payroll excise tax with respect to employment (old age benefits tax) but differ in some particulars. Since the tax has no limit in size of income it is more nearly proportional in burden in case the incidence is on the worker, although it is still regressive since wages constitute a diminishing proportion of larger incomes. The discriminations with respect to high wages and to wages of workers over 65 are not present but are replaced with discriminations in favor of employers with less than 8 workers. In other respects the characteristics of the tax probably resemble closely those of the payroll excise tax with respect to employment. It is the opinion of the committee that because of the distribution of their burdens the payroll taxes are relatively undesirable as a source of general revenue or debt retirement. Many other taxes, existing or proposed, are superior.

To the extent that the payroll taxes are actually used to finance old age benefits and unemployment compensation, respectively, the conclusion is somewhat different. The taxes may then be considered part of the cost of production, namely, the cost of meeting the

depreciation and idleness of labor resulting from the operation of the industrial machine. The incidence and distribution of the burden need not be a matter of concern any more than the distribution of the burden of bond interest or capital depreciation. The tendencies to encourage the use of labor-saving machinery and to shift capital to industries using little labor are probably at a minimum, since the desire of workers to be employed in covered establishments, the order and regulation introduced into the labor market, and possibly other benefits might be expected to shift the burden to the workers and thus to remove the economic tendencies of the tax.

However, the justice of the taxes might be attacked even when they are used to finance benefits to workers, especially in the case of old-age benefits. If the incidence is upon the workers the taxes may be called unjust on the ground that the wages received by many workers do not allow for even compulsory saving,—although the answer here may be minimum wage laws or some other more direct policy. If the incidence of the taxes is on consumers the taxes may be called unjust because the whole buying population supports only part of the population in old age; although this is also true of old-age assistance.

Another objection that has been raised may be mentioned, although it is somewhat out of the strictly financial field. This is that payroll taxes do not lend themselves to a benefit system of universal coverage since small employers, particularly farmers, homeowners, and self-employed perhaps cannot be included for administrative reasons. Whether this is a sound contention must await the results of attempts to extend the scope of the taxes.

Finally, a previously raised point should be made again. The old-age benefits system is only partially contributory in character due to the employers' contributions and to the variations in benefits. To the extent that it is not contributory no reason of tax justice appears to dictate that any special group in the community should be called upon to pay for the benefits or that the community should be called upon to pay benefits to any special group when others in similar positions are not covered.

C. EFFECTS ON FEDERAL DEBT

The unemployment trust fund serves as a market for federal obligations, permitting in effect a transfer of obligations from the public to the fund if the federal budget is balanced, and reducing the amount that must be borrowed from the public if a budget deficit exists. The amount accumulated will probably be relatively small and will vary from year to year.

The old-age reserve account is expected to operate as a means of transferring federal obligations from private hands to the federal

treasury.¹² The transfer apparently will have the same effects on the bond market and on the economic structure that a debt reduction would have. The market for federal securities would be improved. The many economic repercussions of debt retirement would in all probability take place. Whether the transfer actually will take place is, as previously indicated, a question.

With respect to interest, insofar as debt in the hands of the public is decreased, the effect is to shift the annual interest payment from the public to the account. By paying off the debt to the public the payroll taxpayers make it possible for future general taxpayers to contribute substantially to old-age benefits without an increase in total taxes.

D. EFFECTS ON INTERGOVERNMENTAL FISCAL RELATIONS

The part of the social security program having the least effect on intergovernmental fiscal relations is the old-age benefit system, which does not particularly affect such relations except as the payroll taxes may duplicate state levies for unemployment compensation, and as they tend to reduce state and local tax revenues generally, thus making more acute the tax conflicts already existing.

Federal grants for public assistance add no essentially new problem, since grants have been employed previously for other purposes. The financial dependence of the states and the control of the federal government over them are somewhat increased. State-local relations are affected to some extent, since state contributions are required in the case of the different public assistance plans, the amount acceptable being determined by the Social Security Board. This provision combined with one requiring the coverage of public assistance plans to be statewide, means that either the state government must take over entirely the financing of the plans or some scheme of state-local, or conceivably local-state, aids must be set up with sufficient state power over local finance to force the carrying out of the plans. These are substantial changes in state-local relations from those existing in the relief field before the depression and from the relations that have been reintroduced in general relief since the withdrawal of federal relief grants.

The problems of federal-state administrative relations in the public assistance field are presented in probably more serious form than under previous types of grants, because of the nature of the services being performed, as well as the newness of the function.

¹² This may be accomplished either by purchasing bonds for the account in the open market—which can be done only when the yield on the investment is at least 3 per cent—or by issuing special obligations to the account and using the funds to retire outstanding bonds. By either method a transfer of debt from private hands will take place only when there is no budget deficit to be met.

The most revolutionary development in the field of federal-state relations is in unemployment compensation. In form the credit against the payroll tax on employers of 8 or more is not new, since it is an extension of the tax credit device used for a decade in the estate tax. However, the purpose is entirely different. The purpose of the death tax credit is to protect states in imposing substantial revenue taxation on a peculiarly mobile tax base. The payroll tax credit also protects states against tax competition, but its purpose is to encourage the adoption of a system of unemployment insurance. In achieving this purpose, the tax and credit have been eminently successful, no doubt because of the tax loss that any state's citizens would suffer if it adopted no unemployment compensation system.

Some may see in the payroll tax credit little more than a variation of the grant-in-aid. However, the result is quite different. In the case of grants-in-aid, a function that is believed to be of nationwide importance is not only promoted by federal action but is partly financed on a national scale and out of federal revenues. In the case of the tax credit, however, federal tax pressure is used to force the adoption of a nationally desired program at the expense of the states without national assistance. This violates the principle that the geographical area or jurisdiction that is interested in the performance of a governmental function should finance it in whole or at least in part. However, there may be a special justification for this, since it is in effect an application of the "merit rating" principle to the industries of the several states.

The federal grant to cover administrative expenses is of course an element of federal assistance, although a relatively small one. However, here too a problem of federal-state relations arises. With the federal government furnishing all of the cost of administration it inevitably has large powers in controlling administration. The effect of this on federal-state relations will be interesting to observe, although the problem is somewhat outside the fiscal field.

The unemployment trust fund also introduced a new type of relationship between federal and state governments. A policy question will arise if and when a state has used its entire balance in the fund and has heavy compensation payments to meet. The federal government might decide to lend its credit to the state as it did for the short period of the R.F.C. loans for relief.

E. EFFECTS ON TAXABLE CAPACITY

An underlying question that is perhaps not capable of very satisfactory analysis concerns the effects of the social security program on the national income and on taxable capacity. Will present and probable future levels of social security exhaust taxable capacity and bankrupt the country? Quite obviously there are upper limits to the amounts that can be spent on social security in any organiza-

tion of society. With the national income averaging \$415 per capita in 1935 and having an all-time high of \$667 in 1929, the amount of financial security that can be brought to all without a substantial increase in production is not large. In a capitalistic society the level of complete equality, low as it is, could not be permanently maintained since the opportunity of inequality is an important inducement to work and enterprise and the existence of inequalities is apparently necessary to maintain and increase the capital supply through saving. Of course, not all of the social security program operates in the direction of redistribution of income and increasing equality. To the extent that security benefits are based on individual contributions, the existing distribution is not necessarily affected. The non-contributory features, however, do tend to equality, depending to some extent on the taxes employed to finance them.

The question with respect to the latter, however, is not the simple one of comparing such social security expenditures with the national income. Other factors that are involved include: (1) the amounts previously spent in relief and public assistance that are eliminated by the new program; (2) the amounts previously spent by individuals in caring for the aged, unemployed, etc., that are eliminated or made unnecessary. When these and perhaps other similar items are deducted the remainder is a transfer of purchasing power from some persons to others. The strain that this has on taxable capacity depends on the groups from whom the taxes are collected and to whom payments are made; both taxable capacity and saving are reduced by taking from those with surpluses and giving to those with less than necessities.

CONSIDERATION OF SPECIFIC PROPOSALS FOR CHANGE

Both in the federal law setting up the social security program and in the state laws passed to take advantage of the program, as well as in the administration of these laws, are numerous points on which decisions might have been made much different from those actually made. Specific proposals for change have already been numerous. In its limited time the committee has considered only a few such proposals. These have been considered from the viewpoint of their fiscal effects. The conclusions reached are accordingly not definitive since no consideration has been given to non-fiscal purposes. In any event the conclusions are only tentative.

1. THE PROPOSAL TO SUBSTITUTE VARIABLE FOR FIXED PERCENTAGE PUBLIC ASSISTANCE GRANTS

Very great differences exist in the fiscal capacities of different states. Partly as a result of low fiscal capacity some states do not have all of the assistance programs and they carry on those in operation at very low payment levels. Many people have been dis-

tressed by this situation and have proposed that instead of the federal government paying the same fixed percentage of the cost of assistance in all states the percentage of federal contribution should be larger for states whose fiscal capacities are relatively small in comparison to needs for assistance than for states whose fiscal capacities are relatively large. This would mean not necessarily a larger total contribution of federal money for public assistance but rather a different distribution of it among the states, although total federal grants would probably be greater since all states would desire at least as much as they now receive.

The technical problems of variable percentage grants need not be discussed here. The following general method would perhaps be followed. Relative fiscal capacities of the states would be measured as would their relative needs for public assistance. Ratios between capacities and needs would then be computed. States would be arranged in the order of these ratios. Larger percentages of total assistance expenditures would be paid to states with low ratios than to states with high ratios.

Reasons presented for adopting variable grants center in the national interest in having public assistance paid. The fact that the federal government gives grants-in-aid for public assistance, it is urged, demonstrates a national interest in having the job done. The inequality of fiscal capacities makes it impossible for the job to be done in some states and results in an inordinately heavy tax burden in other states. A program of national interest, it is urged, should be universal and should result in substantially equal fiscal burdens on all parts of the nation. Furthermore, it is urged that while the flat percentage grants result in some degree of equalization of burden the opposite result sometimes occurs. Where a state does not adopt an assistance program or carries on a program at a very low level it may contribute relatively more of the federal tax revenues than other states in comparison to the aids it receives. Thus it contributes to financing public assistance in the fiscally more able states while unable to participate in the program itself—a result that is the reverse of equalization.

Various reasons are urged against the variable, equalizing grants. Opponents of federal grants for public assistance in general are of course even more opposed to equalizing grants than to fixed percentage grants since the effect of the former is to place public assistance on a national scale to even greater degree than the latter. Measurement difficulties are another objection to equalizing grants. The distribution of the assistance load among the states is not yet known. The measurement of need involves not only counting the number of cases—a matter in itself involving some difficulties, but also a standard or level of payment. Levels of payment will inevitably and quite properly be lower in some states than in others since

differences in the levels of private incomes affect the levels of relief, but how much lower?

This measurement problem might be met roughly by accepting the level of payment adopted by the state as the amount of need, with upper limits to prevent the adoption of extravagant levels.

Even more difficulty is met in measuring the fiscal capacities of states. Although much work has been done in such measurement with results that for many purposes are satisfactory, scientific results have not been achieved and are not likely to be achieved. Three theoretical problems must first be solved. One is the problem of progression which arises because fiscal capacities of states are made up of the abilities to pay of persons within their taxing jurisdictions. A state in which the average per capita income is \$800 a year obviously has more than 4 times as much fiscal capacity as a state in which the average per capita income is \$200 a year, but how much more is just as impossible to determine as how much more than 4 times as much taxable capacity an individual with \$800 has than an individual with \$200. The second theoretical problem concerns the relative weight in measurement to be given current income and accumulated wealth. Wealth is a source of future income and its possession gives ability to pay, but no one has determined how much ability, if indeed such determination is logically possible.

The third theoretical problem concerns the legal and economic restrictions on the tapping of fiscal capacity. Decisions of the United States Supreme Court in allocating taxing jurisdiction among the states increase the ratio of tax yields to income or wealth in some states as compared to the ratios in other states. Economic restrictions, arising from the danger of taxing a highly mobile tax base especially when competing cities lie close to the state line, reduce the power of a state to tax. How much weight should these restrictions be given in determining fiscal capacity? The economic power is present in the state; not to count it at all is to favor the state, but to count it fully when it cannot be exploited may discriminate against the state.

Lack of satisfactory statistics is also a difficulty in measuring fiscal capacities, which, however, could be met if the government considered the task sufficiently important.

In the absence of an objective measurement of fiscal capacity political difficulties are likely to arise, with one congressional bloc insisting on a measurement formula stressing certain factors while another bloc stressed other factors. An approximate measurement that might be entirely satisfactory for administrative purposes might result in political conflict. Other political problems of significance to finance are also likely to arise. The requirement of matching is a strong deterrent to extravagant demands. Any departure from the fixed percentage principle will throw open the door to all sorts

of demands for federal aid with no well established or accepted principle available to determine the stopping point. Furthermore, efficient administration is more difficult to secure when the share of federal funds is very large, as it might be with a variable grant system.

In the long run increasing pressure for some form of equalizing grant is inevitable. However, due to the magnitude of the social security program we are of the opinion that for the present and near future the main problem is to work out the intricate federal-state relations and administrative problems involved in the act and to observe the experiment carefully, and that only when the probable results are more clearly apparent or when the need becomes greater should variable grants for public assistance be attempted.

The following method has been proposed to accomplish roughly the same results as the previously described variable grants method without raising the measurement problem, in case it is decided to apply the variable grant principle. The method is to give a small, flat, free federal grant for each assisted case in addition to the present fixed percentage grant. The combined federal grants would constitute a larger fraction of the total in states with low levels of assistance than in states with high levels. A limit would be set to the maximum percentage of the total cost that the combined federal grants could constitute to prevent too great reliance on the federal government. Since in general the states with low assistance levels are also those with low ratios of fiscal capacity to need, the result would be a rather rough and inexact method of accomplishing the general purposes of the variable grant without involving the measurement problem.

However, we recommend no attempt to apply the variable-grant principle to federal public assistance grants under the Social Security Act.

2. FEDERAL GRANTS FOR UNEMPLOYMENT COMPENSATION

Unlike the old age benefit system, which is federally financed and administered, and the public assistance program, which is a joint program, the unemployment compensation is almost altogether a state financed program, the exception of federal grants for the cost of administration not involving a relatively large portion of the total cost. The unemployment problem, however, is fully as national in character as the relief problem or the problem of old age, and indeed in some respects is more so. Furthermore, a program of national importance is properly financed at least in part on a nationwide basis. Either a federally financed and administered system or the payment of larger federal grants to the states seems at first glance financially sounder than the present system.

The principal objection raised to the federal system has been that state experimentation is necessary for so new a problem in a coun-

try with such wide variations. Whether the result of the experimentation will be a continuation of state systems, or whether a federal system will prove necessary, is impossible to say at the present time.

Assuming a program of state unemployment compensation systems, an answer to the question whether federal grants should be made in addition to those for administration rests largely on whether the intention is to make the basis of the program merit-rating, which places the burden as completely as possible on the specific employer, on the theory that responsibility can be assigned and unemployment prevented, or to make the basis collective action for the relief of the unemployed. If the principle of merit-rating is accepted, no federal grant is logical, but if the principle of collective action is accepted, federal grants logically follow. Your committee favors a trial of merit-rating, believing that unless it fails, the more collectivistic principle should not be adopted. Accordingly we do not favor the extension of federal grants.

There appears to be a widespread, excessive optimism about the protection afforded by the state unemployment compensation systems. The idea seems to prevail in many quarters that they will make relief unnecessary. This is far from the fact. The maximum payment in most states is 16 times the maximum weekly benefit. No additional compensation is to be paid until the worker through employment has built up a new eligibility. Thus in any period of severe unemployment, the unemployment compensation system will care for the unemployed only for a short time. Thereafter they will fall back on relief.

Furthermore, the federal law fails to consider the possibility that the funds collected by the states will not be sufficient in times of extensive unemployment to pay the benefits that are provided in the state laws. There is serious danger that some of the state funds will become insolvent and that payment of compensation will cease, thus breaking faith with the workers. Most will be lost by the workers who are laid off last, that is, in general, by the best workers, whose employment, ironically enough, has contributed most to the unemployment funds. To prevent this breach of faith, the states and the federal government will no doubt take steps to meet the obligations out of general funds. We do not have any solution to this problem to suggest at this time but believe that it has not been considered as seriously as it should be. Careful study should be given it at once while there is time to make sound plans.

The 100 per cent grant now made for administration presents a very difficult administrative problem. On the one hand the board must control the expenditure of the money by the states to prevent the extravagance that occurs when people spend money furnished by others. On the other hand the social security board must not

set up restrictions on state administrations that will prevent independent management and the development of efficient procedures. A sounder method would appear to be to make a grant of a substantial part of the cost of administration but to require state matching.

In harmony with a previously expressed opinion, we wish to stress the undesirability of the federal government making a "profit" on the federal payroll tax on employers of 8 or more (unemployment compensation tax). At the present time the excess of the revenue over the grants for administration is very substantial. We understand that such is not likely to be the case when the mass of states set up administrative machinery to pay compensation. However, provision should be made in the law that any excess return from payroll taxes in any state over the amount of the grant to that state should be paid into the Unemployment Trust Fund and credited to the state's account.

3. THE PROPOSAL TO REDUCE THE OLD AGE RESERVE ACCOUNT OR ELIMINATE IT

Perhaps the most controversy has arisen over the provision for the building of a large old-age reserve account. The concern is natural in view of the revolutionary nature of the reserve as a device in public finance. Although careful thought should be given now to the question of the reserve, immediate action is not essential since a considerable "cushion" for variations in revenue and benefit payments seems desirable in any case.

The arguments for and against the reserve account have fallen into several groups, which will be discussed in turn.

The first argument to be considered is that old-age benefits comprise a form of insurance and that in the history of insurance the outstanding lesson is that insurance is sound only when a full reserve against obligations is kept. Against this have been brought at least three arguments. It is urged that this is not really insurance because employers are taxed who are benefitted only incidentally if at all and because the relation of contributions to benefits differs according to working life and size of income. It is urged that even if it is insurance the necessity for a reserve does not apply. The need of the reserve in private companies is due to their inability to compel new policy holders to enter the company, while government has the power through taxation to raise the necessary funds to pay benefits when they come due. It is urged that in any case the old-age reserve is no real reserve since it contains only the obligations of the debtor, that it is as if an insurance company placed its own debentures in its reserve and paid the premiums as dividends to the stockholders. Recognizing the present plan of old-age benefits to be a form of quasi-insurance, the committee does not

accept the analogy to private insurance companies since the government can compel continued contributions through the taxing power. The reserve account, however, no doubt strengthens the likelihood that contributing workers will later receive their benefits since it sets up a definite obligation and not merely a congressional policy.

The second general argument to be considered is that the old age reserve will be used to reduce the privately held public debt, thus strengthening government credit and making it easier for government to finance old-age benefits both by making taxes for debt reduction unnecessary and by transferring to the reserve account the interest payment now made to the public.¹³ Against this argument it is urged that the two implicit assumptions, namely, that the debt will otherwise not be paid and that the payroll taxes will be used to pay the debt, are both unsound. The government will have reached a low state, it is contended, if congress will not face the issue of paying the debt and must be tricked into paying it as an incidental effect of the reserve. Furthermore, if congress is of that low quality, what assurance is there that the payroll taxes will be used to reduce the outstanding debt below what it would otherwise be? Nothing in the law says how much of the payroll taxes shall be paid into the reserve account, so that for the next few years, until benefit payments become substantial, they might be used almost completely as general revenues. If they are paid into the reserve account, the result may be as previously indicated to increase governmental expenditures. To the extent that the debt is not reduced below what it otherwise would be, no assistance is given to financing old-age benefit payments and, indeed, government ability to finance them may be reduced, due to the establishment of a higher level of general expenditures. If the debt is paid off in order to set up a reserve that is not intended to be liquidated, the result will have been to place on the shoulders of the payroll taxpaying groups in the community burdens that belonged on the general taxpayers. A redistribution of income—probably in general from workers to capitalists—will result and may have important economic results, the desirability of which might be debated pro and con, but which are somewhat outside the scope of our task.

The committee confesses having grave doubts whether the old-age reserve will actually reduce the government debt (beyond what it would otherwise be reduced) by substantially the amount of the

¹³ Transferring the debt from the public to the reserve account will increase the basic economic capacity of the country to support the aged only if the productive powers of the country are enlarged thereby. Accumulating a reserve in government obligations does not directly result in any growth in productive power. Whether the accompanying retirement of bonds held by the public would result in a net increase in industrial investment and consequent increased production depends on a variety of circumstances whose implications are too complicated for discussion here.

reserve. So long as the market rate of interest on government obligations is less than 3 per cent, special obligations must be issued, and the money goes into the general treasury. While the funds should be used to retire the outstanding debt in the hands of the public there will be many temptations not to do so. We fear the development of a tendency to consider the budget balanced so long as it is not necessary to borrow on the open market. If this should occur general taxpayers will have had their burdens reduced or at least not increased as much as would have been otherwise necessary to finance the level of expenditures prevailing. Regressive taxation of special groups will have replaced general taxation. If the result is one of increased expenditures instead of decreased taxes, the country will enter the period of large benefit payments not only with no reduction in burden on account of the old-age reserve but with an expenditure program inflated beyond what the country would have otherwise chosen to establish and one that once established will, if precedent holds, be very difficult to reduce.

A third argument is that only by using an interest-earning reserve will it be politically (and perhaps economically) possible to impose a rate of payroll taxation sufficient to finance benefit payments. This is a matter of opinion that is perhaps impossible to verify or disprove. Even if correct it would not prevent the use of general revenues to partially finance benefits. It should be noted that as long as the interest yield of federal bonds is less than 3 per cent there is now a partial subsidy from general revenues. Subsidies might be objected to on the ground that the financing of benefits to a special group by general taxation is unfair and should be avoided. This is an objection, however, that also applies at present in case the payroll taxes are shifted to the general consuming public in higher prices. It applies equally as well to the whole assistance program although perhaps with less force. The committee is of the opinion that this general argument of a reserve being necessary because of limitations on the possible levies of payroll taxes does not carry great weight and can be largely disregarded.

The last general argument to be discussed here concerns the relation of the reserve to the contributory system. It has been urged that the continuation of the contributory system is essential. Some of the reasons given are not financial and fall outside the scope of this report; such, for example, is the argument that free pensions pauperize the people and destroy their self-reliance and individual enterprise. On the financial side it is urged that only through the contributory system can the level of expenditures for pensions be kept within bounds. If the free pension system is once begun it is feared that the political demands will increase year by year until the government's financial system breaks under the strain. By linking benefits to contributions it is urged that this result may be

avoided, since every increase in benefits must be accompanied by an increase in contributions.

Your committee accepts the contributory principle as highly desirable; to us the problem seems to be rather whether the reserve is necessary to the operation of that system. A group contribution system does not require a reserve; that is, the body of wage-earners and industries can support the aged without a reserve. The difficulties here arise principally with the first generation of aged. Under the present system they receive to some extent benefits for which their employment has not paid. Without a reserve the whole first generation of aged would in whole or in part receive benefits for which it had not contributed. However, if the system were put into operation gradually there probably would be few if any seriously harmful effects. Such injustice as would be done is common to most governmental activities; they must begin somewhere and some discrimination is inevitable during the transitional stage. The injustice is not as serious as it looks since without a benefits plan the aged must be taken care of by present taxpayers. In any case, of course, each generation must support out of current economic production the aged of that generation; there can be no true reserve in the economic sense.

It has been urged that without the reserve there will be increased demands for benefits. We think that if the benefits are closely tied up to special contributory taxes this can be reduced to a minimum and indeed that the demand will probably not be so great as if there existed a large reserve that was apparently available for the expansion of benefits without cost to present benefit receivers.

On balance, we believe that the large reserve is fiscally undesirable as a method of financing old-age benefits and we urge its abolition in favor of a group contribution system as previously described.

For budgeting purposes at least a sufficiently large reserve should be maintained so that appropriations for old-age benefits will not fluctuate from year to year. The reserve will not of course obviate upward or downward trends in appropriations.

4. PROPOSALS FOR UNIFORM SIMPLIFIED ADMINISTRATIVE PROCEDURES

The concurrent administration of the different types of social security taxation by the federal government and the several states inevitably gives rise to complications. In the resolution adopted at Oklahoma City in 1935, the committee was directed to render a report "embracing suggestions and recommendations on standard rules and regulations for the collection of the taxes and contributions, the type of report from employers and the compilation of required statistics. . . ." It is only during the past year that some of the states

have enacted legislation, and many of the states have not published until quite recently their own rules and regulations. There has perhaps not as yet been enough experience by various governmental agencies to afford a proper basis for your committee to reach a conclusion regarding standardized procedure. The following comments are tentative and preliminary since the committee has not given appropriate consideration to the questions involved.

Although your committee does not believe that extreme simplification or standardization of procedures and reports should be enforced to such a degree that the states will have no opportunity to experiment in search of the best, we are, generally speaking, in sympathy with any move that will permit social security taxpayers to economize in their overhead costs. Obviously an unnecessary cost placed on business constitutes economic waste just as does a governmental expenditure that is not productive of service. The expense to the employer of administering social security measures is in effect a direct tax and should be given the same consideration. As pointed out in the first committee report, if social security is to avoid becoming illusory the resources of employers should not be dissipated by requiring the employment of an ever-increasing number of men on the now very burdensome task of preparing reports.

The different types of rules and regulations so far issued by different states and departments of the federal government display a considerable lack of uniformity that is apparently causing many employers unnecessary expense in compiling the reports. Happily, several of the states appear to have adopted simplified procedures that permit the employer, with a minimum of deviation, to prepare concurrently the statistical information required in reports to the federal and state governments.

An example of the difficulty caused by lack of uniformity among states is in wage-tabulating procedures. Many large industrial concerns have tabulating equipment whereby a card is punched for each employee's wages. This card contains the proper codes to serve in distribution of wages for cost accounting and other general accounting records, and likewise shows such other information as may be needed to satisfy social security requirements. It frequently happens that the payrolls are sent in from different states to a central accounting department where cards are punched under a centralized accounting system. Since the statistical data required by the different states vary, the payroll-taxing procedure then becomes the sole interference with what would otherwise be a coordinated and simplified accounting system.

Another problem has to do with the treatment of additional compensation paid to employees after the termination of the year. Frequently an employer will wait until the end of his fiscal year and then if the profits justify declare a bonus payable to employees as

of a given date. The bonus is in the nature of additional compensation throughout the year just ended. A considerable number of large corporations operate on a fiscal year differing from the calendar year, which means that while such bonuses are made in one year they represent in fact payments for services rendered in two different calendar years when the rates of tax may have been different. Regarding such cases the federal government and the states have issued rulings to the effect that they shall be treated as additional compensation to be spread over the entire year. One state has ruled that not only shall the corporation be required to treat bonus payments of this kind in a retroactive manner, but it also requires an amended return and payment of interest (penalty) for not having paid the correct tax when it was due.

The effect that this has on standardized personnel records that must be used to serve management and federal income tax procedures, as well as all the requirements of social security, may be seen by an example. If a concern pays some time after June 30 a 10 per cent bonus for a fiscal year ending June 30, it means that its reports for the preceding calendar year will have been completed both with respect to state and federal governments. These reports will have to be amended, which would not be difficult were it not for the fact that the law and regulations in all of the statutes so far enacted provide that the personnel records shall contain a complete transcript of periodical salaries or wages. Thus, a personnel record that contains a complete transcript of periodical wages and salaries must then be altered by interlining the 10 per cent additional compensation for each wage payment made during the period. There is also another conflict. The personnel record must contain the accumulated income figures of the individual on a calendar year basis to be reported on information returns to the Bureau of Internal Revenue. With respect to the administration of the federal income tax laws, it must be borne in mind that the bureau has consistently ruled that additional compensation is reportable and taxable in the year when received. Hence, if it is necessary to post the individual's periodical portions of a bonus throughout the year to the record, then the same record cannot provide both the data required for information returns to the Bureau of Internal Revenue and also the data for social security taxation; as well as information to the unemployment commission at a later date if and when the employer is called upon to show what income the individual received at different periods of time since the inception of social security tax legislation. Your committee does not challenge the rulings so far made with respect to this problem; our aim is rather to show that the present laws and regulations may require amendments to avoid an undue interference with business managerial procedure.

The committee regrets the lack of time to go into other questions that are perhaps of equal importance. It regrets the necessity of stating its conclusions so tentatively. However, it wishes to stress the need at this point for analysis and understanding. Due to the newness and complexity of the social security program in American life, the present time is one for open-minded study, and cooperative consideration of proposals for improvement. If the emphasis is placed at these points, definite and trustworthy conclusions will eventuate in due course.

Respectfully submitted,

CARL H. CHATTERS

CHARLES W. GERSTENBERG

CLARENCE HEER

HARLEY L. LUTZ

A. J. MAXWELL

J. W. OLIVER

ROY BLOUGH, *Chairman*

CHAIRMAN SAYLER: The first one listed for a formal discussion of the committee's report is A. A. Imberman, who is research assistant, Maryland State Planning Commission. I haven't had the opportunity of meeting Mr. Imberman. Is he in the conference this evening?

(Mr. Imberman was not present.)

CHAIRMAN SAYLER: Does anyone from Maryland know whether Mr. Imberman is here? If he comes later the opportunity to speak will be given him.

Mr. J. Douglas Brown, professor of economics, Princeton University, will now discuss the report.

J. DOUGLAS BROWN (New Jersey): Ladies and Gentlemen: I feel just as Mr. Imberman must have felt when he decided not to appear.

This committee report is tremendously imposing. I don't know just why I should appear here, since I am a specialist in the field of labor, and not in public finance. Of course, this subject is one of common interest to all of us in the field of economics, and particularly, I feel, in the two fields of public finance and labor economics.

In the first place, I would like to introduce my remarks by saying how important I feel this problem of old age security is in the field of public finance. Harking back to the early days of the committee on economic security, the staff that worked on the bill, the various technicians and technical committees were tremendously overwhelmed when the figures were marshaled as to the probable cost of old age protection in this country.

I will give you two or three figures. Twenty-five years ago we had in this country about 4,000,000 persons over 65 years of age. At the present time we have about 7,500,000, but 25 years from now when most of us will still be in this world, and probably many of us over 65, there will be 13,600,000. During all this period, the trends in economic conditions will be towards an increase rather than a decrease in the proportion of persons needing assistance in old age, because industry is striving to get younger workers, and because technological changes and demand for speed are discouraging the employment of older workers. On the one hand the physical life is extending into the 60's and 70's, while on the other, economic self-sufficiency as far as industrial employment is concerned is ebbing back into the 50's and in some cases the late 40's. From the public finance point of view the job of financing old age security seems to me one of the most imposing tasks for the present and coming generation of tax experts.

I would like to limit my very brief remarks on the committee's program to two or three premises, especially concerning the old age insurance part of the Federal Social Security Act. We can now call it old age insurance. Until it was passed upon by the supreme court the safer title was old age benefits, but even the social security board has now recognized the possibility by calling one of its departments old age insurance division.

Old age insurance, it seems to me, should be looked upon as a particular device, and we hope an effective device, for providing a very necessary social service. It is not a plan for making the federal government a glorified insurance company. The word insurance is unfortunately over-worked and ambiguous. But I must reiterate, this is a device for providing a necessary social service, and is not placing the government in the business of running a glorified private insurance program. I think it is from this confusion that the suggestion arose for the very large and impossible reserve which is now inherent in the present act. It is really a means of preventing destitution, rather than alleviating it after destitution occurs. Its particular philosophy lies in the fact that it is a preventive type of social service program.

The arrangement that there be payments as a matter of right to the old age beneficiaries is not a matter of business, as in the case of private insurance companies, but a matter of social advantage. Payments, as a matter of right involve the elimination of a sense of dependency and the maintenance of a sense of self-reliance. That was the social advantage which was strived for.

It was not a case, again, of running a private insurance scheme where these payments of benefits are a matter of business relationship, so that the particular benefits paid should be precisely related to the contributions furnished. In the first place, the requirement of contributions was to a considerable measure a means of distin-

guishing the program from a relief program. Only by the requirement of contributions can one class of persons be distinguished in the payment of benefits at time of old age from those who are given funds as a matter of relief. Secondly, it was a means to create a basis for the particular payments made, and thirdly—and of course very important—a source of funds from which those benefits should be paid.

It seems to me those of us concerned in taxation and the solvency of governmental institutions should look upon the social security act and contributory parts of it—that is, particularly the old age benefit part—as a very important device to control future expenditures of government.

One of the most important elements in the old age benefit program is that it is a device to buttress incentive on the part of our working population, rather than to discourage incentive. We all know what happens to relief. The last depression has writ in large letters again the almost necessary evolution of relief programs. That is, that they tend to become larger, that certain parts of them, at least a hard core, remain with us indefinitely. With this tremendous old age problem ahead of us, therefore, it seems tremendously important that we avoid as far as possible the dangers of a growing old age relief burden. The principal device that we can use to prevent that, it seems to me, is the device for old age benefits which maintains incentive rather than discourages it. It is this contributory feature of requiring employees as well as their employers to contribute, with the device of paying benefits related to contributions, which is fundamental in a scheme to encourage incentive rather than to discourage it.

It seems to me that that is the vital American element in the existing old age benefit scheme. In Great Britain there is a flat rate of contribution and a flat rate of benefits. It is what you might call a purely basic type of old age protection. It does not provide the middle groups of economic incomes with any satisfactory security for old age. In our scheme the thing sought was to provide a means of encouraging rather than discouraging our higher paid workers, in that they would receive more benefits if they were employed more years and employed at higher wage rates.

I would certainly like to commend the committee on its extremely intelligent analysis of the large reserve problem. It seems to me that this is one of the greatest dangers in the whole program. It is an unnecessary danger. This provision of the act was due to a confusion of thinking, and was the outcome of the application of what I like to call "tradesmen's economics" to a problem that should be treated as a problem in political economy. When you try to lift the economics of the corner grocer, who is certainly in the right when he builds up cash reserves—try to raise that sort of a squirrel-like, thrift-like habit, which is very sound in its proper

application—to the policies of government, you are indeed confusing two very different things. It seems to me that the large reserve is a treasury device, a device favored by the United States Treasury officials in meeting a treasury problem, rather than a proper device of social insurance. You will find that in practically every other country, when they came to apply social insurance, they departed from the notion of large reserves.

Finally I would like to say that there are certain suggestions as to the revision of the old age insurance act which were not commented on by the committee, and properly so perhaps, on account of the limitation of the area they were covering. Certainly a worthwhile suggestion in preventing the old age insurance scheme from breaking down, in the face of a rapidly mounting old age assistance load and a rapidly mounting appetite for old age assistance, over against a contributory type of protection, is that there should be an acceleration of payments under the old age insurance to some time such as 1939. It is very questionable whether the American people, particularly in some of our western and southern states, and especially in those states where the Townsend movement was strong, will wait until 1942 for these old age insurance benefits without being swayed by the attraction of old age assistance for which they pay no contribution.

I would like to commend the committee on the advice that the government should go slow on the matter of variable matching in the case of old age assistance. It seems to me that it is dangerous medicine to depart from the old logical device of fifty-fifty matching between federal and state funds in the case of the old age assistance. To go from that to the device of variable matching may look scientific, but it seems to me fraught with many serious dangers.

Finally, I would like to give one note of warning. It looks very likely to those students of unemployment insurance who are not tied up in governmental activities that unduly liberal benefits and merit rating provisions in many state unemployment insurance acts are putting the funds of those states on the road to insolvency in the case of a major depression. Anyone who can add up income and outgo in the face of changing business conditions can see that some of the state plans for unemployment insurance are bound to become insolvent. Your problem as persons concerned with the general tax programs is how that insolvency will be met. It seems to me that it is well within your interest to recommend that unemployment insurance be at least planned to be solvent, so that it will not cause a drain on other funds of government at a time when funds are very difficult to secure. If nothing is done within these states, it is bound to become a federal problem, and it will probably hasten the day, which many of us think is inevitable, when the unemployment compensation systems will be merged into a general national system.

Thank you.

CHAIRMAN SAYLER: We are deeply indebted to Professor Brown for his very clear statement of some of these problems.

I think all of us who have had anything to do with this social security legislation, either from its technical side or from its economic phase, realize that the whole setup simply bristles with questions that will take the earnest attention of specialists and students of economics if we wish to get down to a sound basis.

It is my understanding that there were expected here tonight certain representatives from Washington who are identified with the administration of the Federal Social Security Act. I am not sure whether any are present. If they are I wish they would make themselves known. I think as a matter of courtesy, that if they are here we should accord them first an invitation to be heard.

The meeting is open for general discussion. I realize that in a thing of this far-reaching type it isn't easy to get up in a few minutes' address or talk and clarify your position, but in the face of the rules as to a short limitation, I want to say that those who care to speak on it will be given consideration.

In speaking, please give your full name and the state from which you come.

HARLEY L. LUTZ (New Jersey): I merely want to ask Mr. Brown a question. I would like for him, if he will, to elaborate on the subject he was discussing as he left the platform, namely, the future outlook for the unemployment insurance schemes. I understood him to say that these would become bankrupt, but I wasn't certain whether he meant that to be true in case of a major depression, or whether he anticipated bankruptcy in the ordinary course of handling the usual seasonal short-time fluctuations in the labor market aside from the very severe effects of a major depression.

MR. BROWN: That question—coming from my own institution.

It is, of course, all a matter of relativity. I would certainly say that should we have a depression of the degree of seriousness of the late depression, a considerable number of state funds would become insolvent. That is, they would not be able to meet the promised benefits. My reason for saying that is this: that in the first place it would have been required as an average for the country as a whole—I can't remember the exact figures—a full 3 per cent tax for the payment of benefits of approximately twelve weeks. But we know that many states have a load much heavier than average.

Take my own state, for example. In New Jersey we have a rather heavy cyclical unemployment load, because we are highly industrialized and we have a very small agricultural backlog to steady the employment curve. In our own state we felt it necessary not only to have 2.7 per cent, that was usual as the contribution rate, but we added a 1 per cent employee contribution. We promised

16 weeks of benefit, but then along came the merit rating provision which normally tended to reduce the average of contribution.

In some states they permitted the merit rating system to work only one way, that is to reduce contributions but not to increase them, in the case of employers with unstable records. In our state we require that employers continue to pay the full rate should the fund be reduced by a certain amount. Likewise, we put in the penalty rate, which was considerably higher than 3 per cent, in the expectation that that would offset the lower rate for good employers.

Since merit rating has been added in practically all states, a very large number of states, since they took advantage of the lowest rate possible, 2.7, and since many of those states have a relatively heavy cyclical load of unemployment, there is every reason to expect that they can't meet the burden of the payments that they promised, should they get into a serious depression.

How serious it is is a matter of guesswork. But our country is becoming more and more industrial, and the fluctuations in industry over against, of course, agriculture, mean that more states are becoming susceptible to a heavy cyclical load rather than less.

Does that answer your question?

MR. LUTZ: Don't leave, Mr. Brown. I want to ask another question, if I may. I don't want to keep others from speaking.

CHAIRMAN SAYLER: I think it is very proper that you ask a question, and I would like to have Mr. Brown answer you.

MR. LUTZ: I want Mr. Brown to follow up this question of merit rating because of any light he may throw on the extent to which that reflects possible over-optimism with respect to the future problem of maintaining unemployment benefits.

As I understand it, merit rating means that because of a good labor record you pay less, but how does that help the case if and when you run into a jam with respect to the amount of unemployment on your hands? Is it a sign of over-optimism with respect to the future load?

MR. BROWN: I think it was very definitely a sign of over-optimism in the way it was managed in a good many states. In other words, they permitted certain employers like public utilities who could do it readily to reduce their rate of contribution gradually down to 1 per cent and in some cases down to zero, without reference to the condition of the general fund. So that the general fund may be approaching insolvency, and yet the XYZ public utility company may be paying zero contribution.

On the other hand, I again cite our own state, New Jersey, as an example of the way it was handled in certain states. It was fought very strenuously by our leading public utilities. We have

an arrangement whereby should the fund become less than one year's payment, or less than twice one year's payment, in the first step, then by so much, merit rating is limited, and in fact there will be no merit rating unless the fund has on hand at least a full year's benefits, that is, the amount of funds necessary in the previous year to meet all obligations of the fund.

CLARENCE A. JACKSON (Indiana): I just came in, so I don't know what has happened before.

CHAIRMAN SAYLER: Would you care to step to the platform, Mr. Jackson?

MR. JACKSON: No, I just want to leave a little thought. In doing so, I would like to make one remark on merit rating that we should all remember. I happen to be administering this unemployment compensation in Indiana along with other laws. One of the prime purposes is the hope that it will offer an inducement to employers for stabilizing employment, and the idea of merit rating, if it works, is to offer a cash dividend for those employers who are able through some means to help accomplish that purpose.

Another point, on the matter of the fund going broke—that might happen. My personal judgment is, after considerable research, analyzing it, and talking to officials of the General Electric Company, who have operated a plan like this through the depression, that it is rather remote, because we must recall that there are brakes on this plan. A man does not draw twelve, fifteen, or sixteen weeks just because he is unemployed. He only draws to the amount of money that he put in. In some states it is 4 per cent of his salary per quarter, or 16 per cent per year on the previous year. In Indiana 16 per cent is the limit.

In our own state we now have a reserve fund that would take care of a total unemployment of those that are insured now up to 35 per cent. So it doesn't look as if the thing is going to be insolvent very soon.

Then keep this in mind, gentlemen; as employment increases the benefit rights decrease also, because when a man is unemployed he is not piling up new rights. When he is through drawing what he has coming, whether it is one week or twelve, he has no more rights until he has been employed once more and has accumulated rights.

The thing I wanted to leave with you, and I hope it will not be a repetition, is this: we administrators of this law are confronted with an almost impossible administrative problem. That unquestionably is coming before congress, and if it is understood out in the states I think it will be helpful. If any of you men are interested in this, you know we have been in session from last Monday morning until last Saturday night and accomplished absolutely nothing, as is usual when you go to Washington. Three departments

are attempting to run the show, three departments, at a duplicate or a triplicate expense to the contributor, the taxpayer.

There may be a reason why the states and the federal government should both collect under title 9—that is unemployment. We have a field force of some fifty people in Indiana, and the federal government has about sixty-five, collecting exactly the same tax. There may be a reason why the federal government should collect it all. There may be a better reason why the state should collect it all. In my judgment and that of my associates, there is certainly no reason why both of them should be working at the same job.

The treasury department in the field is always causing the contributor, the taxpayer, a lot of grief in that the results vary. It is no fault of the treasury department, understand, but they are collecting this tax not under an unemployment compensation law, but as directed to act under the net income tax law of the United States. There are many complaints of cases where the taxpayer frankly doesn't know what to do.

Another conflict is between the treasury or between the labor department and the social security board, through the employment offices and through the board. Just as an example, gentlemen, in the state of Indiana, a small state, starting with the budget that we have to turn in in January, which will be 3,060 copies, if you please, we will have 47 offices. They demand a line budget, how many pins, how many pencils, red, black and green, all the way down for each one of those offices—17 copies each, 4 times a year, and you cannot transfer a paper-clip from one to the other without the permission of Washington.

That is why, I repeat, we administrators are faced with an almost impossible problem of doing a good job in our states. I am not crabbing. When they passed that law they probably did the best they could. There was an excuse for it to be like it is now. There is absolutely no excuse for the situation to continue beyond the next session of congress, and I hope when you go back to your states, you who are interested in this problem, and you surely are, you wouldn't be here otherwise, that you will get in touch with your state administrators and be prepared to give them a helping hand to get this straightened out in a businesslike way so that you will reduce your costs and increase your efficiency. Thank you.

CHAIRMAN SAYLER: I think one of the very great advantages of these conferences is that here public sentiment on these problems is crystallized, and when you get a fair-minded consideration of it and state it here in understandable terms, the basis is laid for legislation, state or national, that would tend to smooth out these inequities and injustices and, I should say, put it on a sounder and more simplified basis.

Is there anyone else who wishes to be heard on this question of social security?

PAUL STUDENSKI (New York): I would like to make some observations.

CHAIRMAN SAYLER: Will you please come to the front of the room, sir? It is very difficult for everyone in the room, including the reporter, to hear unless you use the microphone.

MR. STUDENSKI: I hope those who will follow me in the discussion will not hold it against me for establishing a bad precedent in submitting to the request of the chairman and coming up here on the platform in order to present some very few, perhaps not very essential, remarks.

As a matter of fact, I wanted first of all to ask the chairman whether it would be proper for me to make some observations on the question of the financing of old age insurance. Inasmuch as a very interesting discussion has begun on the subject of unemployment, that unemployment section of social insurance, I do not wish to divert the discussion from that very important subject. I want to ask if perhaps I should defer my remarks until that subject shall be discussed, because in my judgment it would be rather bad if the discussion should switch from unemployment insurance to old age insurance, because the financial and other problems are so different.

CHAIRMAN SAYLER: It is perfectly proper for you to make your remarks on old age insurance. The only comment I have is that the question under discussion is the social security act, and a part of the social security act deals with old age pensions. Therefore, we would be glad to hear anything you might wish to say.

MR. STUDENSKI: Thank you.

I do not find in the social security act or in the reports accompanying that act any well conceived theory or program of accumulation of reserves against the old age benefits. The usual insurance concept of an actuarial reserve is that of the accumulation of a fund sufficient at the time when the payments will be made to cover the requisite payments. In the social security act, and in the reports, it appears that the reserve is merely a function or the result of the fact that certain rates of contributions have been fixed to be paid specifically by the employee and the employer, contributions conceived to be reasonable, and the fact that these contributions will for a great many years exceed the benefits which will be paid. Hence the accumulation. So that the accumulation is merely a result and not an instrument or well designed purpose or system of necessarily paying the benefits.

There are only two ways of doing away with an actual accumulation of a reserve. One is to reduce the rates of payments by the employees, wage-earners, and to reduce the payments by the employers. That is one method. The other method is to increase the benefits or to assume to pay the benefits earlier than is contem-

plated. Of course, there is a possibility of doing both of these things, and in this fashion reducing the accumulation of reserve, or possibly doing away with an actual reserve accumulation altogether.

Proposals are now on the way to increase the benefits and to make the benefits payable earlier. I cannot conceive of anybody seriously proposing that in the event the benefits should be increased or additional benefits provided, such as benefits for the survivors and so forth, or that the benefits be made payable earlier than they are, the contribution rates should be increased. I think anybody who would make such a proposal would be probably scorned or laughed at.

It is not certain at all that any large reserve will actually be accumulated. I presume that the committee in its final report will make it clear how it will propose to do away with or reduce that reserve under the present rates of contribution.

Professor Blough in his opening remarks referred to the fact that there are different philosophies in the old age phase of the social security act. One is the philosophy of compulsory saving by the wage-earners. The other is the philosophy of the payment by the employer for the depreciation of the wage-earner, and accumulation in that way of funds against his inability to work during his old age. The third philosophy is the philosophy of social obligation in general, that is, a social provision irrespective of the income of the person, a provision on the basis of the community of interests, the social benefit that may result from a provision against old age of the members of society.

I don't find, again, that these philosophies are clearly represented or worked out in the social security act. Of course, the committee of the National Tax Association will have to come to an agreement on the particular social philosophies they sponsor. As a matter of fact, I had a little private conversation with Mr. Blough in advance of the presentation of his report. It is perfectly evident that it will be necessary for the committee to come to an agreement on this subject, because the fiscal arrangements are the outcome of the particular social philosophies.

Let me illustrate it. If the social security act is to embody permanently the principle of compulsory saving by the wage-earners, then it will be necessary to change the system of benefits provided in the law, and it will be necessary to relate the amount of benefits payable to the wage-earners much more closely to the contributions paid by the wage-earners than is done at the present time.

As a matter of fact—and here is the point which I would like to suggest to the committee for its concentration—it would be necessary to separate clearly the contributions—if you will pardon me, I am using the word contributions instead of taxes—payable by the wage-earners from the contributions or taxes payable by the employers.

In my judgment the two should be kept in separate funds or accounts and the benefits should be definitely split. There should be a separate benefit payable from the wage-earner's own contribution. Call it annuity, if you please. But have the wage-earner receive a benefit at the time he retires, an annuity which is definitely related to the amount of money which he has paid together with the interest which that money has actually accumulated or theoretically is entitled to. Then have another benefit in his total retirement allowance, which is financed from the payroll contribution of the employer and perhaps from an additional contribution furnished from the general funds of the government and a contribution or tax based on principles of ability to pay, but at any rate expressing that third philosophy that has been mentioned, the philosophy of social obligation; but at any rate the benefits that would be necessary in order to provide the wage-earner with an adequate amount in his old age.

That additional benefit necessary to provide him with an adequate amount should come from the employer's contribution and from the social contribution, and under the social security system every wage-earner should have a very definite knowledge that his money is being preserved for him, that an account is kept and the money that he has contributed will under all events be paid to him. Under the present system I may cite many cases in which the benefits payable will not be equal even to the wage-earner's own contributions.

For example, in the case of the death of a wage-earner, three and one-half per cent will be paid to his widow. Three and one-half per cent of the total wages, in the case of long payments, will not be equal even to the total amount which the wage-earner has contributed to the fund, together with interest.

So far as the reserve problem is concerned, here again I would like to suggest that the committee might find it worth while to consider the reserve accumulated from the wage-earner's own contributions separate from the problem of a reserve provided by the employer's contributions or general taxpayers' contributions. There is more justification for an accumulation of reserves in the case of the wage-earner's own contribution than there is in the case of the payroll contribution by the employers or any general social contribution that we may perhaps eventually provide for in the social security act.

A. D. SCHULTZ (Ohio): The purpose of title 9 was to force the states to enact unemployment compensation laws. I should like to ask the social security committee what reasons there are for continuing that title in the act. Why not repeal it?

CHAIRMAN SAYLER: Mr. Blough, do you wish to answer that?

MR. BLOUGH: I should think the Ohio law, if I remember correctly, gives the answer to that question. If I am not mistaken, there is a provision in the Ohio law that in case the federal payroll tax is repealed the Ohio law is automatically void. The statement was this: that in the Ohio law, I think—and I am quite sure this is true in some other laws—the provision is made that if the federal payroll tax either is repealed or is declared unconstitutional, the state law goes out of existence at that moment.

As long as you have states taking that position and as long as you have the danger of competition among the states, some sort of federal incentive to protect the states against each other and to induce the states to continue these laws will probably be necessary.

That would be my answer. I don't want to monopolize the committee's answering, however. I think the other members of the committee should answer.

CHAIRMAN SAYLER: Does that answer the question, Mr. Schultz?

I think consideration should be given to the matter by the committee. There is certainly no reason why the matter can't be corrected under state laws.

Does any other member wish to comment?

PAUL J. WIMSEY (Illinois): These gentlemen have delivered some very fine papers here tonight showing that they have given a lot of study to these problems that now confront us, and I am wondering, as a representative of the taxpayers—and there are others here—whether or not these plans contemplate a continued ability on the part of the employer to meet the obligations that are being heaped upon him? I have in mind a large corporation that has paid taxes in recent years with money it has borrowed from the federal government. These corporations can only continue to pay as long as they have profits over earnings.

Plans that are being made for the care of the aged and the unemployed, or whoever it might be, that are looking for support from business, surely provide some safeguarding of business. I would like to ask these young men with their brilliant thinking and brilliant minds if their plans have gone that far.

CHAIRMAN SAYLER: Of course, you get down into the fundamentals of a lot of these questions today on that. I don't know whether anyone has the courage to stand up here and attempt to answer that question. I would be glad to hear from them.

MR. WIMSEY: I want to add that my remark was not at all meant to be facetious. I think those remarks are really serious. I think it is a problem that is confronting us today, and we are going to have to consider it just as thoroughly as we are considering these other features.

I want to say that I endorse and approve heartily all of these social plans for alleviating the suffering as long as they carry with them this incentive, that the young man speaks of, for a continuation of effort on the part of the individual. I don't want our country, our people, to become drones. I want them to become enthusiastic, hard-working Americans. But I don't believe they will continue to be so if it is just a matter of handing out to them without some effort toward preserving the business that is doing the handing out.

MR. BROWN: In the first place, this question why shouldn't congress repeal title 9, now that the states have seen the light, reminds me of a shotgun wedding. The shotgun may bring about the marriage but you need more than a shotgun, perhaps, to make him support the girl. I don't know whether some of the businesses would get a divorce or the easier thing, just leave the state.

As to the other point about the question as to whether we can support these types of contributory taxes, let us go into the history of the old age insurance. In the fall of 1934 and the winter of 1936 we were faced in this country with the question of whether we would or would not take care of old persons. We were faced with a tremendous drive for the Townsend plan and about 50 other types of more or less honest projects for the protection of aged persons in this country.

That was a groundswell matter. That was not merely a bright idea on the part of a rather aged physician in Los Angeles. He merely happened to be the man who came out with the publicity, or his friends did. There was a definite groundswell interest in old age security, and we still have it very definitely.

What did that bring about? It brought about a condition in congress which was bound to put through title 1 of the social security act, that is, the federal matching of state funds for persons 65 and over, as a matter of relief, without any payments on their part, while titles 2 and 8 were developed as a means of control for future expenditures of old age security. The states were helped thereby—that this old age assistance would not grow like a snowball until it would cost us something like \$4,000,000,000 a year in 1980; to have instead a contributory plan which would maintain incentive, where benefits would be related to contributions, the amount of wages earned to the number of years of employment, and so on. To do that it was necessary to develop a contributory scheme.

So I would put the shoe on the other foot and say it isn't so much whether you want the contributory plan or not, but rather whether you would prefer a contributory plan which maintains those things that you and I want to see maintained; or, do we want an outright relief plan which is bound to grow by leaps and bounds as it has in every foreign country and as it already has in many of our states?

A. J. MAXWELL (North Carolina): Just a word of explanation, if I may; conflicting assignments prevented my attending the meetings of this committee today and participating with them in shaping the report presented.

As presented to the conference here this evening, I am impressed that Mr. Blough, the chairman of the committee, has done an exceptionally thorough and creditable piece of work. I just wanted the privilege of concurring in the report with this slight reservation, if I may for a minute be facetious, that is, the frequently used term in the report of a first-class depression.¹ I assume that the particular delicacy of the meaning that the gentleman was searching for was to describe the depression as really "lousy".

CHAIRMAN SAYLER: Mr. Lutz, did you wish to say something?

HARLEY L. LUTZ (New Jersey): I don't know that I can qualify, Mr. Chairman, to answer the gentleman from Illinois, because he called upon the young men who made up the committee, and it would seem like presumption on my part to speak; but since the young men declined the honor, perhaps I should rise to say that the committee did not go into the particular question that he raised.

Perhaps we looked upon the answer to it in much the same way that the answer has been found in many other quarters to similar questions and perhaps it was beyond us, but I might say that Professor Brown's figures as to the amazing growth of the aged, including myself now very soon, makes me wonder whether we have the right way after all, or whether the old Spartans and many of the Indian tribes didn't have it, namely, when a person reached a certain age he just went out somewhere and that was the end of him. He didn't return. The tribe didn't have to feed him any more.

This whole question of a nation undertaking to support itself in this way is fundamentally a problem of economics. What we want to do is to maintain a standard of real income that will be adequate for all members of the community. Obviously, it will be impossible to do that, no matter what we do with respect to the redistribution of wealth and income, unless we can maintain a sufficiently large flow of production to supply the whole community with an adequate real income.

If a larger and larger proportion of our total population is to be of advanced years, owing to the declining and eventually stationary birth rate, or possibly even a diminution in the total number of our population by reason of the very small number of births, then those who are able to work, those who own capital, must be stimulated all the more to energetic production of goods and services in order that there be enough to support both the working population and those who are for physical or other reasons unable to work.

¹ As orally presented.

There is one aspect of this particular matter which at this point I am a little reluctant to inject, although it bears upon the subject, lest I be accused by Commissioner Maxwell of attempting to change the character of this conference as he alleged the conference at Indianapolis was unduly influenced, but I must say that if we could consider simply the social security program as the one thing that we are undertaking to do, and could drop 99.44 per cent of the rest of the experimenting, we might have a chance to see the productivity of the nation grow to a point at which we would be able to carry that load. But as long as the job of promoting real economic security for the whole nation, which is our fundamental job, is going to be hamstrung by a lot of other things that stand in its way, then I can give the gentleman from Illinois no assurance whatever as to our capacity to handle that job.

CHAIRMAN SAYLER: It is no part of the duties of the chairman to give views on a matter of this type. I only want to call attention to one thing. I am not expressing my own personal view in the matter, but as I read in the press and in the magazines about this thing, I think that sooner or later the federal government is going to be faced with the problem of a shorter time basis on which to carry through this program.

In other words, the raising of the money for the purpose of old age and for unemployment would have to be done on a shorter time basis than on a long-time basis as stated. I think it is one of the big problems that this country, both the states and the federal government, must solve.

C. W. TERRY (Illinois): I would like to ask just one question, and that is whether the committee gave any consideration, and if so, what consideration, to any other provision that might be inserted in the social security act whereby those whom we expect to protect will be induced themselves to lead thrifty and constructive lives?

Of course, I realize that the contribution paid by the employer is something, but for years I have battled with the thought in my own mind since labor first suggested it, and since then I have always been in favor of legislation of this kind. But I have always feared that it would result in greater carelessness of life and dissipation among those whom we are trying to protect.

If there is nothing to induce us to be conservative and thrifty and saving, but if we feel that we are going to be taken care of anyhow, why, I have always feared that many of our citizens would say, "What's the use, let's just have a good time and let 'er go."

I would like to ask what consideration has been given over and above that which has been expressed both by the members of the committee themselves and by the various splendid analyses that have been made?

MR. BLOUGH: I can say that the committee, while it is very much concerned about the question of the individual and the inducements to the individual to be thrifty, to save and so on, has not turned up any devices as yet by which that might be accomplished. I wish we might find such.

On the effect on private lives of individuals and their tendencies to save for themselves, I haven't very much information. I have read statements to the effect that this whole program was stimulating the provision that individuals were making for the future for themselves. They hadn't given very much thought to their own old age, and this whole agitation about care for the aged induced them, when they saw how small the benefits were going to be and so on, to go into some program of taking care of their own old age.

So far as I am concerned, that is purely a hypothesis. I have read excerpts here and there that that has happened. I have absolutely no evidence that it has happened. I can see that might be the result. I for one am sure I would be most happy if you can supply a suggested method of accomplishing the desired result.

MR. BROWN: Frankly speaking, one of the parts of the social security act which was eliminated on account of pressure from the private insurance companies, was the provision for voluntary individual annuities, and it was the feeling of many that that was a serious loss, because among other things, it would have provided a means on a cost basis under very convenient arrangements for individuals, especially older individuals, to have augmented the very low benefit rates under old age insurance. It would have permitted that under various terms as much as \$50 a month additional—and at one time there was talk of \$100 additional if a man cared to put in that much—could be paid in regular instalments as a contribution in addition to the compulsory contribution.

I want to confirm as far as my information goes that there has been a stimulation, not only of individual annuities, but also a very definite stimulation of company pension plans since the passage of the social security old age benefit part of the act.

CHAIRMAN SAYLER: There is one member of the committee who has kept silent through this. I don't know whether he wants to offer anything or not, but before closing I would like to hear from Mr. Gerstenberg.

CHARLES W. GERSTENBERG (New York): Mr. Chairman, all I wish to say is that when the committee report came to us about ten days ago, I was the most surprised person that I have ever been. I had assumed that Mr. Blough would give a tentative report of perhaps 10 or 15 pages. I think it is wise that everybody here know that he came through with a report of 41 pages, the most difficult kind of reasoning. I struggled with that for some little

time and have made a few suggestions. We worked on it today perhaps a total of about three or four hours. I think it is due to Professor Blough to say that the work is so largely his that no credit should be given to the rest of us except that we have tried to encourage him as much as we could. We wrote to him at various times.

If I did have anything to say on any particular phase it would be probably on that part that has interested some of us, the equalization, paying more than a certain percentage to some of the states.

I just throw out this thought: that if we did that, I am afraid that we would be encouraging the marginal lands, and I feel that the economic consequences of protecting parts of the country that are not able to sustain a population would be in the long run a very bad thing. The best thing that can happen to those states, as well as to the whole country, is to leave those as marginal parts, just as we have in connection with our agricultural land. We have given up the poorer lands and are concentrating on the better lands, and I think that for the generation that we have, the generations to come, the best thing that we can do is to keep strength where it is.

I know in business you advertise when business is good. You don't advertise when business is bad. So we ought to help the flourishing and let the weak take care of themselves. That is a very stern doctrine, I will say, but in the long run I think it is the best doctrine.

I hope that the committee will be continued and will have a chance to think out some of the other parts. I would say, however, to the gentlemen present, that it was a difficult task to differentiate between the economic aspects of the question and the financial. We have tried very hard to keep to the financial, and Mr. Blough did a very fine job on that.

I, for one, if I continue as a member of the committee, will lend my influence to see that we stick to the financial, then go to some other association to hear them discuss the economic and political aspects.

CHAIRMAN SAYLER: I now declare this session on social security closed and will turn the gavel back to Dr. Leland.

S. E. LELAND: Just a minute before you go out. We won't be but a few minutes. We have one or two announcements to make and hope that you will see fit to listen to them.

Mr. Query!

SECRETARY W. G. QUERY: These are the same announcements I made earlier in the evening, but as some of you have come in since I made them I feel I should make them again.

Tomorrow afternoon at one-thirty in the lobby of the Lord Baltimore Hotel the ladies will gather and will board cars and buses for a three-hour sight-seeing trip around the city.

On Wednesday afternoon at one-thirty they will meet in the lobby of the Lord Baltimore Hotel to be taken to the Hippodrome Theater for a movie party.

Also I will read again the letter from the Baltimore City Rotary Club addressed to Judge Leser:

"MY DEAR JUDGE LESER:

"Will you kindly extend to the members of your association convening here a most cordial welcome to attend the regular luncheon meeting of this club on Tuesday, October 26, 12:15 noon, meeting in the Florentine Room, Lord Baltimore Hotel.

"If possible we should like to have a memorandum of the number who will visit with us so that proper accommodations may be made. This information can be telephoned to our club office, room 464, Lord Baltimore Hotel, by those expecting to attend."

MR. LELAND: I want to call attention also to the fact that the session in the morning will commence promptly at nine-thirty.

I want to congratulate the committee on its fine report and our presiding officer on his able execution of the evening session.

There being no further business to come before the conference, the meeting is adjourned.

(Whereupon, at ten-fifteen, the meeting adjourned.)

FOURTH SESSION

TUESDAY, OCTOBER 26, 1937, 9:30 A. M.

SIMEON E. LELAND (Illinois): If the session will come to order, we will start by having Mr. Query make the usual announcements.

SECRETARY W. G. QUERY: There will be a meeting of the association of states on bank taxation — most of the delegates at these conferences are familiar with this association and its purposes — at 4:30 in parlor F. That is the parlor in the rear of this room. It is desired that everyone interested in the matter of taxation of national banks by the states attend this meeting.

This is a meeting separate from the National Tax Conference, but the officials and the program committee of the National Tax Association wish to cooperate in every way possible in seeing that there is an attendance at this meeting this afternoon.

I wish to repeat the announcement about the entertainment for the ladies. If they will meet in the lobby of the hotel here at 1:30, they will be taken for a three-hour ride around the city.

SIMEON E. LELAND: The presiding officer for this morning's session is our good friend, A. J. Maxwell, of North Carolina. He needs no introduction to you, to me, or to anyone else.

A. J. MAXWELL, presiding.

CHAIRMAN MAXWELL: Mr. Leland, Members of the Conference: We have assigned for consideration at the session this morning a subject that is of interest in all the states and of particular interest in a large number of states, the subject of tax limitations and homestead exemptions.

I am sure you are all familiar with the situation that has developed with respect to property taxation in recent years, with respect to the question of homestead exemptions. They have been adopted and applied in varying amounts in different states. In my own state there was ratified by a large majority at the last general election an amendment authorizing the general assembly to give a homestead exemption not exceeding \$1,000.

When the general assembly met the proponents of that measure were very modest in their requests, and only asked that the general assembly utilize the discretion given it under that amendment to the extent of an exemption of \$300. However, the general assembly was not willing to go even that far without having more definite information than it had at that time, as to the effect the exemption

would have on the budgets of local units of government. In our state it has no bearing whatever on the question of state finance, because we have no state tax on property.

The general assembly therefore created a commission to make a detailed study and present to the next session accurate and well considered information as to the effect such action taken under this authorization would have on the finances of local units. So this subject is of particular interest to people of my state, and I am sure it is to those of other states.

The committee report will be presented by Raymond D. Thomas, dean of the School of Commerce, Oklahoma Agricultural and Mechanical College, chairman of the committee.

I note that this is the only subject that we have assigned for consideration this morning, and I hope that we will have liberal general discussion of it, particularly by the states that have had experience under it.

Inasmuch as it is the only subject assigned this morning, while we will pay due deference to the rules of the organization as to time, perhaps we will not be too meticulous about it.

I take pleasure in presenting Mr. Thomas.

PRELIMINARY REPORT OF THE COMMITTEE OF THE NATIONAL TAX ASSOCIATION ON PROPERTY TAX LIMITATIONS AND HOMESTEAD EXEMPTION

RAYMOND D. THOMAS,

Dean, School of Commerce, Oklahoma A. and M. College,

CHAIRMAN

The Twenty-ninth Annual Conference on Taxation held in Indianapolis in 1936 adopted the following resolution:

“WHEREAS, proposals for homestead exemptions are pending in a number of states; and

“WHEREAS, a proposal for complete abolition of all taxes on property has been advanced in one state and similar proposals in other states, therefore be it

“RESOLVED, That this conference recommend to the National Tax Association that the committee on homestead exemptions be continued and that it be expanded to eleven members; and that said committee be empowered to undertake a study of all proposals for restriction of property taxes and make all information so obtained available to the official agencies of states where such proposals may be pending, and to make such reports to succeeding conferences concerning its progress and findings as the committee may deem proper.”

At the time the resolution was adopted there appeared to be considerable concern in Michigan as to the possibility that the voters in the November, 1936 elections might ratify a pending proposal to abandon the property tax in that state. A similar proposal was being considered in Minnesota. The complete abolition of the property tax has been actively agitated during recent years in many states. It is generally well known that the movement to exempt homesteads from taxation has since 1930 spread among the states like a contagion. Several states have already by either statutory or constitutional enactment restricted the total or overall property tax rate within definitely prescribed limits. A committee on homestead exemption in a preliminary report at the 1936 conference registered some general doubts as to the basic economic and fiscal soundness of the homestead exemption movement. To the present and enlarged committee has come the task of making observations on, and to the extent possible studies of all proposals and schemes for limiting, restricting or abandoning the property tax. The resolution would also appear to have this committee serve as a kind of clearing agency through which information germane to property tax limitation proposals would be distributed to states in which proposals are pending. A committee of eleven members rather well distributed over the nation and with no funds for the maintenance of a secretariat could hardly be expected to perform this function of a clearing agency. Attention is called to the language of the resolution to the effect that the committee be authorized to make reports to "succeeding conferences" concerning its observations, studies and findings.

It is not the purpose of this report to present an exhibit of statistical data related to property tax limitation. Probably most of the members of the conference are acquainted with the studies which show the fiscal effects of homestead exemption. Rather thorough studies have been made in Alabama, Georgia, Kansas, Mississippi, Oklahoma and Utah. These studies consider the fiscal effects of homestead exemption from the static point of view. What long-run economic and fiscal results can reasonably be expected to follow the adoption of homestead tax exemption is still an uncertainty. Only time and experience can produce the evidence. The long-time effects of any change in a tax system are of more importance than are the immediate effects. Already appearing are unmistakable signs that once the exemption practice is started a strong pull is begun for increasing the size of the exemption and for extending the exemption to other classes of property.

No complicated or lengthy analyses are necessary to demonstrate the immediate effects on state and local revenues which would follow the adoption of an overall limitation of the property tax. The stock arguments, *pro* and *con*, on the limitation question are generally well known. This committee would have small claim for existence

should it undertake nothing beyond a restatement of these arguments. The committee is not prepared at this time to submit a final conclusion on any one of the larger aspects of the property tax limitation question. In this first report we have in mind two purposes; namely, to examine the property tax limitation movement, including homestead exemption as one aspect, in relation to governmental changes and the current revolution in taxation and to raise some general questions with the view to stimulating discussion in this and we hope in succeeding conferences.

The upward turn in the normally ascending curve showing the expansion of government activities and increasing public expenditures has coincided with a period of post-war economic readjustment. During these nineteen years past, tax-paying capacity of some industries and individuals has been up and down. But for agriculture and farmers as a whole the capacity to contribute to the public purse throughout the whole period has been diminishing. The great depression of the early thirties reduced the ability to pay taxes of owners of income-yielding real property toward the zero point. For numberless thousands this decline of ability sank below zero. Little comfort can come from a detailed portrayal of the plight of the property tax payer and of property tax supported government services through the depression—the sharp and long downward sweep of real property prices; a dead real estate market; critical dislocations of costs and income resulting from the continuance of high fixed capital charges and taxes at a time when income sank to the lowest levels for generations; mortgage debts defaults and foreclosures; increasing tax delinquencies; government budgets out of balance with mounting current and bonded debts.

A more unfortunate conjuncture of economic circumstances could hardly have been visited upon a nation than this: the resort to the use of the superior powers and agencies of government to meet the exigencies of a nation-wide and serious economic crisis at a time when tax-paying ability was at a low mark. Small wonder that the joining of events of such magnitude should start a revolution in taxation. Property taxpayers took the lead in the revolt. The positions of the combatants are known. The lines of battle are drawn. The poor with little tax-paying ability against the rich with much ability, small and individual economic enterprise versus corporate business, income and inheritance taxpayers against sales taxpayers, property taxpayers against any one or the whole combination of other taxpayers.

The determined stand of the property-owning group in this battle of taxation is not the result of a quick or impetuous decision. Evidence of a disproportionate portion of the total costs of government, particularly of local government, paid by owners of real property has been presented and analyzed in practically all of the textbooks in public finance published during the past quarter of a century.

Academic students of taxation have marshaled facts in abundance which show how inertia has caused real property to remain as a measure of ability to pay taxes long after economic changes created rights in intangible property and new sources of income with attendant ability to support government.

Advances in property tax reform have been made in most of the states. The percentages of total costs of state and local government paid from property tax revenues have been declining throughout the nation. In states where twenty or thirty years ago property tax revenues provided from eighty to ninety per cent of the total annual outlays for state and local government services, including the servicing of debts, the percentage is now down to around fifty per cent. These reductions, however, as a general rule have been in terms of relative figures rather than in absolute amounts. In particular jurisdictions, improvements have been made in property tax administration. But at best, property tax reform has made rather slow progress—too slow to satisfy either the advocates of reform or the owners of real property. It is the judgment of the committee that in this urge for bettering the property tax, reform has far too generally been measured in terms of *immediate results* in the reduction of the size of the total or individual property tax payments. Interest has naturally been centered on the *objective* of tax reduction almost to the complete disregard of the *means* used to accomplish the purpose sought.

The exemption method offered promise of relief, and sometimes complete release, from the property tax for certain groups. State constitutions by providing for exemption of certain classes of property from the property tax—property of religious bodies, and non-profit fraternal and charitable associations, for example—have established a time-honored and respectable setting for the exemption movement within the property tax. Restricted property exemptions in state tax systems are of fairly long standing. As a general rule, these exemptions have been confined to relatively small amounts, and they have applied in the main to personal property. Heads of households, the mentally and aged infirm, and ex-soldiers and their widows have been the chief beneficiaries of these exemptions. It can be expected that continued effort will be applied toward a more liberal interpretation of the constitutional and statutory exemptions from taxation of the real and personal property used for religious, fraternal, and charitable purposes. The story of exemptions of property of new industries is well known. The exemption of homesteads from the property tax is the most recent, and it can be correctly added the most popular and disturbing of all the applications of the exemption doctrine.

The homestead exemption movement is one phase or aspect of the current revolution in taxation. The movement is popular because it promises an immediate reduction of taxes paid by a quite large

group of taxpayers. The advantages of strategy in the movement are obvious. A kind of crusading spirit can be aroused. Crusaders for homestead exemption march forward under effective slogan banners—"Save our homes against attacks from the tax eater", "Lift the tax burden from our American homes", "Encourage home ownership and better citizenship", and others of similar kind. The social objective of an increase in home ownership, which it is claimed will result from homestead exemption, has wide appeal. But the prospect for a large and immediate drop in property taxes paid by home owners (who live in their homes) as a benefit to so large a group is the principal and most effective means in winning the support of candidates for office. And how few are the homeowners who would not vote for a proposal to reduce their taxes immediately! In the adoption of homestead exemption in one form or another in several states since 1933—Texas, Louisiana, Florida, Iowa, Minnesota, Georgia, Oklahoma, Utah, Alabama—we have concrete evidence of the gains already made by one group of property owners in the revolt against property taxes.

It should be pointed out that the homestead exemption issue has uncovered sharp conflicts of interest within the property-owning group. The exemption of homesteads, if it is effective, shifts the portion of the total of all property taxes, represented in the amount of the tax reduction resulting from exemption of owner-occupied homesteads, either to other classes of taxed property or to other sources of revenue. To the extent that this shifting raises taxes on the non-exempted classes of property we can expect increasing resistance to homestead exemption within the property-owning group. It seems reasonable to expect that this resistance will in the future be more articulate and outspoken. Investment companies and other owners of foreclosed real properties and bonds issued against industrial real estate, apartment houses, and rental business properties could not be assumed to be disinterested in a movement which might cause an increase in taxes on these classes of property. Property owners, either as individuals or as groups, are in the thick of this battle of taxes. They are not always united. Proposals for reform like homestead exemption and property classification plans which place certain classes in a protected or preferred position in relation to assessments and tax levies—these proposals, on account of the conflict of interest involved as between different classes of property owners, lead to breaks in the ranks and internal strife.

Two other movements representing departures from traditional property tax policies and practices have developed considerable momentum during recent years; namely, overall property tax limitation and debt control, and the abandonment of the property tax entirely. Whether either or both of these movements will enlist the united support of property owners as a whole is a matter of uncertainty. Accumulating evidence now points toward the possibility of

general acceptance and adoption of some form of property tax limitation and debt control in the various states. During the past quarter of a century either statutory or constitutional property tax limitation has been adopted in Ohio, West Virginia, Indiana, Oklahoma, Iowa, and Washington. In most of the states provision has been made for the control of the public debt. A constitutional measure is now pending in the state of New York designed to establish by a gradual process a more effective limitation on the property tax and the control of bonded indebtedness. On the other hand, present signs indicate that the complete abandonment of the property tax and the substitution therefor of some kind of a gross receipts or transactions tax is not likely to gain very wide support in the states. But agitation for gross receipts and general turnover taxes in lieu of the property tax will probably continue as a disturbing element in well-considered plans designed to stabilize state systems of public finance.

The current revolution in taxation and the growing popularity of the limitation and exemption movement within the property tax field are important factors in what seems to the committee to be an emerging crisis in federal and state public finance. We believe that this preliminary report can probably be of most help in the initial stages of the committee's work by submitting to the conference some general propositions on the existing public finance situation in the United States, and further by submitting some general preliminary statements relating to property tax limitation and homestead exemption.

GENERAL PROPOSITIONS RELATING TO THE EXISTING PUBLIC FINANCE SITUATION IN THE UNITED STATES

1. CHANGES IN GOVERNMENT

The tempo and character of current economic, social, and political changes are creating difficult problems of adjustment as between the public and private aspects of our total national economy. Concretely, this means that taxpayers generally are finding it difficult to adjust themselves to the requirement of increasing the ratio of their payments into the public treasury to their total private or personal outlays. Needed is a new coherency of public and private functions in our economic life and therefore of public and private finance. It would be difficult to estimate how great will be the social loss if the people of the nation fail in this important undertaking. There is urgent need also in all the states for a new appraisal and a new understanding of the economic and social purposes of taxation. Here is another matter of important concern to the general welfare which should be discussed "in every school house in the land."

2. CONFUSION IN THOUGHT AND ACTION ON TAX POLICIES

The activities of well-organized economic groups with the end in view to securing relief from what they consider to be disproportionate burdens of taxation (each group thinks it is paying too large a part of total taxes); the growing tendency for adequately financed and well organized group agencies to use propaganda methods in nation-wide campaigns to reduce taxes paid by a given economic group; the appearance of new functions of government (social security, for example) and the tendency to "ear-mark" certain taxes for specific purposes; the dislocations of functions as between different levels of government and the rapid increase of federal and state subventions to lower units of government; hurried and rather sweeping action in bringing about changes in state tax systems under the banner of so-called "tax reform"—all of these conditions and more which might be mentioned have brought both thought and practice in taxation to a state of confusion. Among tax students, tax administrators, and legislators there is a lack of agreement on basic principles of taxation.

3. NEED FOR CAREFUL PLANNING OF STATE TAX SYSTEMS

There is a growing need for careful and thorough planning in all of the states with a view to building *tax systems* which will provide for reasonable adjustments between the new requirements of government and the conflicting views and interests of individuals and groups concerning taxation. The committee desires to state with emphasis that the property tax limitation and homestead exemption movement should be considered in relation to the larger problem of building a state-local tax system. Moreover, this movement has a direct relation to problems and policies of federal finance. We would emphasize further the importance of building tax systems for the reason that there is an apparently spreading practice in the present scramble for revenue in both state and federal governments to enact tax legislation by the piece-meal or patch-work method.

PRELIMINARY STATEMENTS CONCERNING PROPERTY TAX LIMITATION AND TENTATIVE CONCLUSIONS ON THE HOMESTEAD EXEMPTION MOVEMENT

1. MOVEMENTS FOR RESTRICTING THE PROPERTY TAX IN RELATION TO THE TAX SITUATION AS A WHOLE

The committee believes that sound conclusions relating to the property tax limitation and homestead exemption movement cannot be reached if the movement is considered apart from the federal-state tax situation as a whole. Hurried action in adopting limitations on the property tax or in approving a homestead exemption plan may seriously weaken the current fiscal condition and the credit

of both state and local governments. In the name of *tax reform* and because of their strong popular appeal, either or both of these steps might be taken hastily with little thought of the immediate effect of such action on the entire financial situation. We could hardly warn too positively against this tendency to act quickly on tax questions as important as these. Generally speaking, a period of economic depression is not the most appropriate time for fixing a rigid limit or for approving a large exemption anywhere in the tax structure. Adjustments to changes in a tax system can be much more easily made when times are good, when governments are not struggling for necessary operating funds, when public bonds are not defaulting. A proposal for limiting the property tax or for the control of public debts can and should be drawn in a way to provide that the plan become operative by gradual steps. The proposal for an overall limit on the property tax and the control of debts now pending in the state of New York is a pattern which other states which desire to take a similar step can well afford to follow.

Proposals for changes in a tax system, and property tax limitation and homestead exemption are no exception, should always proceed from one or more generally accepted and basically important premises. One premise which, in the judgment of the committee, should be a point of departure in logical thinking on any proposal for a change in the tax system is this: government services, representing a sound balance between individual and public functions in the national economy, *can* and *should* be adequately financed. Let it be emphasized here that *adequate* financing of government means not only a sufficiency of public funds, but also a regularity or certainty of the flow of public receipts to balance outlays for capital improvements and expenditures for current operations. This, of course, is a commonplace truism in the literature on taxation. Nevertheless, it is in the probability that advocates of property tax limitation and homestead exemption will overlook this premise that great danger lurks.

2. CENTRAL QUESTION IN PROPERTY TAX LIMITATION

Again let us return to the premise above stated. One of the questions before the committee is this: what portion of the funds required to finance the total of government services should be derived from the property tax? Or to put the question in a different form, what portion of total taxes levied and paid should be levied upon and paid by owners of property merely because they happen to have legal title to the property taxed? Let us recall here the essence of the property tax. It is a tax paid by persons who own property *because they own property*, and not because of any other condition whatsoever. It would be unreasonable to expect that property owners just because they *own* property should pay *all* the

capital and operating costs of government. Moreover, it would be unreasonable to affirm that all costs of government should be paid by taxes levied upon and collected from persons who receive net incomes (net above deductions and exemptions) merely *because they are receivers of such net incomes*, or that all costs of government should be paid by taxes levied upon and collected from persons having net interests in property rights coming to them through inheritance, merely *because they are receivers of these rights*. No one would seriously propose a *single tax* of the kinds mentioned or of any other kind—sales, motor vehicle, gasoline and so forth—with the possible exception of the *single tax* on the economic production attributable to natural resources.

Some members of the committee believe that existing conditions in our tax situation as a whole warrant the imposition of an overall limit on the total taxes levied on property. The point at which this limit should be fixed they are not at this time prepared to say. It is the view of other members of the committee that a fixed maximum limit on the property tax or any other tax is both impracticable and unsound. Further observations, studies, and deliberations are necessary before we would undertake to formulate a general conclusion on this matter. It appears to the committee that the point of the limitation of the property tax if adopted, should vary up or down in terms of variations in economic conditions in different taxing jurisdictions. The committee desires that it be understood that we are not advocating general adoption of an overall limitation on the property tax. It may be that property owners, as *property owners*, are paying in some states too large a portion of the costs of government and in some states too small a portion. There seems to be general agreement in the committee that the predominant problem in this whole question of tax limitation is that of securing a balance between the maximum limits under given circumstances which would apply to each of the several kinds of taxes which as far as we can now safely guess for the future will remain in our state tax systems. It is an ideal worth striving for that this balance be such as to place the least possible hindrance upon both the production and the consumption of wealth.

3. NEED FOR A NEW DEFINITION OF PROPERTY FOR PURPOSES OF TAXATION

Consideration of the many aspects of the tax limitation and home-
stead exemption movement, particularly from the point of view of
the history of the property tax, discloses the need for the formula-
tion of a logical and practical definition of property as a subject of
taxation. If we were recommending a property tax *de novo*, what
would we include in the definition of property subject to taxation,
and why? Such a question compels careful analysis of the suitability
of every category of so-called property within the scope of the

property tax base. We might be able to agree upon a base to which we could apply a reasonable limitation of the rate. If we could agree on a definition of the base of the property tax, the question of exemptions would disappear. The concepts of taxable property have been "growing" like Topsy through many centuries while at the same time economic society has been undergoing fundamental changes. It should not be surprising that confusion on concepts exists. Consider, for example, the hopeless lumping together of utterly dissimilar concepts of tangibles and intangibles, or the conflict between the popular notion of property in *things* and the legal concept of property as *rights* in things. If the lawyer is left to have his own way he may even define *property* as something which the layman regards as *income*. Some of our highest courts, it will be remembered, have held a legislative act levying a tax on net income unconstitutional on the ground that a tax on income is a tax on property. The committee is not certain that its assignment is broad enough to warrant our going into this whole matter of formulating a definition of property for purposes of taxation.

4. THE PROPERTY TAX LIMITATION PROBLEM IN RELATION TO FEDERAL FINANCE

Sooner or later there must be a "show-down" in federal-state finance relations. In a desperate effort to keep the treasury personnel from becoming too much experienced in handling the large figures on the outgo side of the ledger, the federal government is tapping more and more sources of revenue. In reality, the property tax remains as the sole important revenue source untouched by the central government. The strong arm of the federal taxing power is being extended further and further into the revenue resources of the nation. There is hardly a community too small but that it has either a resident or an itinerant federal tax collector. The reality of increasing federal taxes makes more difficult the task of state and local government of financing the services of government near the people.

Will it come to pass that this double-barrelled effort to get at the taxpayer may cause the people to determine to throw off that portion of the double payment which goes to the state? Locally, the people can have but small effect in reducing or removing a federal tax, but locally they can command state and local governments to reduce taxes. Might it be possible that one important result of widespread and increasing federal tax collections will be the gradual shifting of support of state and local government back to the unlimited property tax? It may be that property tax limitation affords to the states the means for warning the federal government that they do not propose to return to the almost exclusive property tax of former years. By drawing the lines on the upper limit of the

property tax the states may by indirection give effective assistance in checking present and it may be future spending orgies of the federal government.

5. HOMESTEAD EXEMPTION

The committee is in general agreement, though not unanimous, on a tentative conclusion concerning the proposal to exempt owner-occupied homes from taxation within certain restrictions as to dollar value and area. The careful analyses of the effects of homestead exemption which have been made show that wide differences of benefits will result from any particular type of exemption plan adopted as between owners of small homes and owners of large homes, owners of urban homes and owners of rural homes, owners of homes in local areas of large total assessed valuation and owners of homes in areas of low total property values, owners of homes in areas of relatively large valuation of business and industrial property and owners of homes in areas of a limited amount of such property. Since exemption of homesteads tends to decrease the size of the property tax base, a tendency is appearing in some of the homestead exemption states to increase that total rate levied on property. Homestead exemption is advocated as a means for encouraging home ownership by placing owner-occupied residence property in a position of economic advantage. This would mean a direct economic gain to home owners. As a matter of theory, it can be strongly contended that these gains could accrue only to present home owners since the economic advantage would tend to be capitalized at the next transfer of title. The advantage in the exempted tax would thus be offset by added capital costs. The burden of proof that a permanent benefit can and will be realized by home owners from homestead exemption is on the advocates of the movement. It is claimed that homestead exemption will cause an increase in home ownership. Here again the burden of proof is on the advocates of the movement. The committee knows of no evidence which would establish the validity of either of these two claims.

The central question in the homestead proposal is this: assuming that agreement can be reached on the portion of total costs of government which is to be paid by taxes on property, is it in accord with sound public policy to exempt the *owners of certain classes of property*—members of lodges, members of churches, owners of homesteads, for example—and *certain classes of owners of property*—ex-soldiers and their widows, newly established industries, for example—from the property tax requirement. The majority of this committee are of the opinion that we shall more likely achieve sound tax systems in the states by placing a reasonable limit on the total property tax payment, with few exemptions allowed. If it is sound

for owners of property, *as owners*, to pay within the restricted limits a portion of the total costs of government, any exemption of *certain classes of owners* or of the *owners of certain classes* of property is, we believe, a departure from sound tax theory and practice. The property tax can be justified on the basis of both the ability to pay and the benefit principle of taxation. Homestead exemptions, as well as all other exemptions, leads away from these foundation principles and into considerations aside from the essential purpose of taxation for the support of government services. Effort should be made to discourage further exemption of property from taxation. The right step in relation to exemptions within the property tax would probably be in the direction of the abandonment of property exemptions of every kind.

So ends the presentation of the preliminary statements and tentative conclusions of the committee. Perhaps "suggestions for discussion" would be a better phrase, for the committee has not arrived at a final judgment on any of these statements. It is hardly to be expected that the committee would be unanimous on all the points receiving either minor or major emphasis in this preliminary report.

It is recommended that the committee be continued, without reference to its present personnel. We do not claim that the committee can evolve a "Model Property Tax Plan", but continued study and discussion should prove helpful in bringing about a better articulation of the property tax with other kinds of taxes in federal and state tax systems.

RAYMOND D. THOMAS, *chairman*
ZENAS W. BLISS
EDWARD P. DOYLE
T. LEVRON HOWARD
JENS P. JENSEN
M. B. MCPHERSON
H. D. SIMPSON
A. H. STONE
JAMES W. MARTIN

(At this point the members all came to the front of the room to get papers from the table.)

CHAIRMAN MAXWELL: This temporary confusion has been due to an effort to secure the mimeographed copies of Mr. Lavery's paper on court decisions. The secretary informs me that sixty additional copies will be made available during the conference, for the benefit of those who did not get a copy this morning.

Mr. Thomas and his committee, it is apparent, have done a great deal of thinking on the subject of the paper presented this morning, and some very careful thinking. I am sure the conference is indebted to him and his committee for this very comprehensive report.

The first gentleman assigned to discuss this report, according to the program, is Mr. Herbert U. Nelson, secretary of the National Association of Real Estate Boards. Mr. Nelson was not able to be here this morning, but he was good enough to give us by wire the views of his association with respect to tax limitation and homestead exemption:

"Deeply regret urgent business has compelled me to return to Chicago following our Pittsburgh convention which adjourned Saturday. Our association favors limitation on real estate tax. We have never discussed nor advocated limitation on total amount of taxes that may be levied, and believe such limitation to be impractical. Our association has not advocated homestead tax exemptions but we regard them as inevitable throughout the country unless some limitation on the real estate tax is imposed. We assert that due nature of real estate investment, real estate taxes must be the fixed item in the public budget and that other forms of taxation must be resorted to for flexibility. Please express these views to the committee."

The next gentleman assigned on the program to discuss this paper was Mr. Graham Aldis, vice-president of the National Association of Building Owners and Managers, of Chicago. Mr. Aldis is not present with us, but Mr. Harry J. Gerrity, of Washington, D. C., general counsel of the National Association of Building Owners and Managers, will discuss it in his stead, so the chair is advised.

Mr. Gerrity!

HARRY J. GERRITY (District of Columbia): Mr. Aldis, of Chicago, the vice-president of our association, asked me to come over from Washington this morning to show our interest in this subject of tax limitation and homestead exemption.

The National Association of Building Owners and Managers desires me to express the deep interest which we feel in the work of the committee on property tax limitations of the National Tax Association, and I wish to briefly present the views of our association in regard to the subject of homestead exemption.

The National Association of Building Owners and Managers is a federated group with national offices in Chicago, and composed of forty-eight local associations of building owners and managers in all of the large cities of the country, representing ownership of real estate in the form of office buildings, apartment houses, and other income-producing property. It is estimated that our group speaks for an investment of six to ten billion dollars of commercial real estate throughout the country.

In the matter of local taxation, with all its evils and complexities, we feel that there is no substitute for real economy. The movement for homestead exemption is, in the view of our association, improper

and unsound. If this movement should accomplish the results which the proponents seek there is no assurance that the tax load will be reduced or the tax burden on real estate materially diminished, but rather there is a direct tendency to shift the tax burden and the cost of local government to the shoulders of those least able to pay.

Admittedly, those who advocate homestead exemption legislation have popular appeal on their side, as it holds out some tangible hope of lightening the tax burden, at least on smaller real estate properties. Mr. Frank S. Slosson, past president of our national association, has stated that:

“Homestead exemption does not lighten the tax load—it merely shifts it. Certainly, in our larger cities more people live in apartments than in individually owned homes. Both pay taxes (whether direct or indirect) and the larger number must pay a higher tax in order that the smaller number may pay a lower tax. That is hardly consistent with our principles of equal rights and equal responsibilities. Where the situation is reversed and home ownership prevails, the effects are even more pronounced. The curtailment of revenue is more extensive and the consequent hardship imposed on other types of property, assessed against a relatively smaller number, is proportionately more severe.”

What really happens, where homestead exemption has been made effective, is that in devising ways and means to offset the amount of the exemption, a good deal more is tacked on, resulting in a general increase, rather than any lightening, of the entire tax load. This works at cross purposes with any program which seeks to confine the tax on real estate within reasonable limits. The immediate effect of tax exemption applying to any class of real estate is to increase the assessment against every other class of real estate, and income-producing property, which already carries more than it can stand, will be further penalized. No cleaner-cut example of the burden to office buildings created by homestead exemption could be found than the law now in effect in Iowa. The plain arithmetic shown below emphasizes the necessity for aggressive opposition to homestead exemption in any state where it is proposed. Prior to its adoption in Iowa the percentage of assessed value to real value was 60%, with the 55-mill rate. An office building having a real value of \$1,000,000 had an assessed value of \$600,000 and the tax thereon would be \$33,000. Under the recent Iowa law now in effect the office building is assessed on 100% valuation less homestead exemption, with the result that instead of the assessed value being \$600,000, or 60% of the real value, the assessed value is \$997,500, or real value less homestead exemption of \$2,500. The resulting tax on such an office building in Iowa is \$54,873, instead of \$33,000, prior to homestead exemption.

The movement for homestead exemption directly affects business properties, and our association feels that the only sound principle in dealing with the real estate tax problem is that of uniformity—all treated alike, without discrimination. Then there will be no favorites, and any constructive measures, uniform in application, will have undivided support.

Tax exemption is not only inequitable—it is uneconomic. Mr. Slosson says: "I might go further and say it is dangerous, setting up class distinctions, intensifying rivalry between farm and city, and leading to consequences destructive in character, out of all proportion to the incidental benefits that are claimed for it."

Mr. Ronald B. Welch, research consultant of the National Association of Assessing Officers, has recently stated that the movement for homestead exemption is growing rather than declining; that instead of affecting the property tax rate, this movement is affecting the base, and affecting it seriously. Mr. Welch states that "the strongest argument against homestead exemption is that it violates all principles of equity. If homestead exemption really does foster home ownership, it can do so, it would seem, only at the expense of tenants. It is obvious that we can't all gain at once, whether by a \$200 monthly pension or a \$2,000 homestead exemption. And there is no reason why tenants should pay the way of home owners, who, as a group, are undoubtedly better able to pay taxes than tenants."

In conclusion, our association is willing to join and actively cooperate with all other groups in opposing the further spread of the homestead exemption movement, because we believe that the underlying theories of homestead exemption are unsound, and that the evil consequences of all special exemption schemes should be avoided.

CHAIRMAN MAXWELL: Both of the subjects covered by this report, that of tax limitation and homestead exemption, are now open for general discussion. May I suggest that it would be desirable for those who participate in this discussion to come to the front and give their names clearly for the benefit of the reporter.

EDWARD P. DOYLE (New York): A very well known citizen of Virginia said a great many years ago that the only guide to the future was the lamp of experience.

Fifty-three years ago, New York state, alarmed at the constantly increasing taxation, passed an amendment to the state constitution, providing for tax limitation of two per cent in seven cities and eleven counties in the state. That has been operating for fifty-three years, and I have never heard that it in any way affected the efficiency of the government in those cities or counties or that there was any difficulty about it whatever.

Since that time, of course, things have been made worse for the property owner, because of the widening of the suffrage, which

doubled the number of illiterate voters and trebled the number of voters who are susceptible to speeches made by demagogues who talk about the abundant life and old age security and made it still more necessary that there should be some check on taxation.

Four years ago in New York City, because people did not pay their taxes, the treasury was left in very bad shape, and it was necessary for the city to borrow \$70,000,000. The bankers were called together and they agreed to lend that amount provided we would give them an agreement that the tax rate would not be increased, and in addition, that there would be a limit of one and three-quarters per cent in the budget of the city, a quarter of a cent less than the two per cent limitation of the constitution.

The next year the budget was \$81,000,000 less on account of that provision. That lasted for four years. It expires this year. There is no question about lack of efficiency in the government, and the taxpayers had the benefit of the saving of that \$81,000,000.

This year that agreement ends, and the new budget for next year, of course, will be the full two per cent allowed under the constitution.

The only way that I can see to prevent the spending of money, with the property owners in so small a minority and the people who want the use of taxpayers' money being in so large a majority, is some constitutional limit. In New York state we have tried to make that limit—and will before the next constitutional convention—one and three-quarters per cent, exclusive of debt service. We realize, of course, that the debt service must be met, and we are very strongly—the Real Estate Board of New York, representing about, I think, a half at least of the \$16,000,000,000 assessed valuation of the city—in favor of a constitutional limit of one and three-quarters per cent, exclusive of the debt service.

As far as homestead exemption is concerned, I will tell you what that would mean. A lady came in the tax office the other day and complained about the assessment on her home. The assessment was \$8,000, the tax rate two seventy-six, I think it was, in Queens. You can figure up what her taxes amounted to. I was present and the president asked her how many children she had.

She said, "Eight."

"How old is your eldest?" he asked.

"Nineteen."

"What is he doing?" he asked.

"He is in the City College," she replied.

"He asked, 'How old is your next child?'"

"Seventeen, a daughter."

"Where is she?" he asked.

"She is in another college."

Everyone of those children was in school, high school or college, and being educated at an expense to the city of about \$2,400 a year. Yet she was objecting to paying two seventy tax on \$8,000.

Right next to her was a two-family house where a man lived in the lower part of the house and rented the upper part. He not only had all he could do to keep going, but probably by this time has had his place foreclosed and taken away from him by the owners of the mortgage. He had no children. He would pay an additional tax, if you exempted the homestead tax, to the one the woman who owned the house next door paid.

I can't see that there can be any benefit gained by exempting anybody, because the people who own the homesteads are the people who get the greatest amount of benefits from taxation.

I have always had to pay for the education of my children and my grandchildren in college, although I have never had very much money, and I have never objected to my taxes. I have never protested a tax assessment on any of my property. I have always realized that I ought to pay a reasonable tax. I don't believe, though, of course, in having a totalitarian state like I see over in Europe every year, and have the government a beneficent father taking care of everybody and taxing me for it.

I was on the Russian border when they shot a young girl for milking a cow and drinking some of the milk herself without turning it all over to the state. I also heard about farmers being killed for not turning all the grain they raised over to the state to be used to feed the Red Army. I don't want to be taxed for something in this country the same way.

Other than that, I think we have had a very fair system of real property taxation. I have been a supervisor for a great many years—or I was, rather, and I represented a great deal of real estate. I have never made very much protest against it except sometimes when assessments were unequal. But we have to do something about making it certain what a man's tax is going to be before he will buy a piece of property. I don't think I would ever buy another piece of property because of the uncertainty as to what I would have to pay. There ought to be some sort of a constitutional limit so that a man who buys real estate would know that his tax was going to be the same as a man who goes into business or buys anything else.

The real estate board is opposed to homestead exemption but very strongly in favor of a reasonable limit on taxation.

CHAIRMAN MAXWELL: The chair will recognize Mr. McPherson.

M. B. MCPHERSON (Michigan): Mr. Chairman, Members of the National Tax Conference: First I would like to express the appreciation of the people of the state of Michigan for the resolution that you passed at the annual meeting in Indianapolis last year. Copies of that resolution were given to all the metropolitan papers and to the news-service handling it, weekly papers, and so forth,

and it received friendly, very friendly, and favorable comment through the editorial sources.

We pointed out when those copies were given to them that this organization was not a group of tax spenders but consisted of the administrative officers of the states together with the representatives of the people paying millions of dollars of taxes.

You remember that in the fall of 1936 when we came before the group at Indianapolis, we were faced again with two very bad constitutional amendments. Number four was the one that was to take away the right to levy any taxes of any kind on any property, that is, real estate or tangible personal property. Number three was the so-called sales tax. We were very fearful that number three might pass, but not so fearful of number four, because we succeeded in defeating it two years before on a homestead exemption of \$3,500.

After we returned from Indianapolis I had the pleasure of again being made the goat as chairman of a committee to go out and fight number three. We have a setup in Michigan by which we bring in certain interests, and we have been very successful so far in going out on an organized "vote no" campaign in the fall. A "vote no" campaign is easier to organize than a "vote yes" campaign, for the reason that at least twenty-five per cent of your people will vote "no" anyway.

If we get in the realm of practical politics here it is going to be outside partisan politics, because that is out when we come to this stuff. If twenty-five per cent of the people vote "no"—and that is a minimum; all you have to do is just urge them to do it—you have only to get twenty-six per cent more and you have anything beaten. You see, when you start a "vote yes" campaign, you have to get fifty-one per cent.

The city of Detroit gave this number three amendment 70,000 majority. That was to take the three per cent sales tax off of food. But outside we succeeded in getting enough "no" votes so that we had a 400,000 "no" majority in the state, and just 50,000 people less voted on that than for the president of the United States. You folks know there were quite a lot of people voting last fall.

Following Mr. Doyle and Mr. Thomas on this, we believe that if you haven't something to offer the people that they think is fair, you are sunk. We believed in Michigan that we did have a fair distribution of the revenue of the state, so we told the school people, the highway people, and the people interested in old age pensions and direct relief, "If we can preserve this \$12,000,000 for you, you are the folks that get all the money; not the other type that is paying some of it—but you pay some and you get all of it." They really believed it, and they are getting it.

So we preserved it, and when the legislature met they did try to fairly divide this up. Then the governor and the legislature, of course, were faced with a budget of about \$20,000,000 more than

the state had. That is the same old game. The legislature adjourned, went back home and said, "We voted for it." Then the governor had to veto it, so he got all the blame and the legislature got all the credit. It is a good system but it catches up with you.

I think Mr. Thomas spoke of the fact that when the receipts of the money were about fifty-fifty, half on real estate and half on other sources, on an even balance, we were there. Before our property tax limitation came in the people of Michigan paid \$264,000,000 of property taxes. That is, they were supposed to pay them. Some of them didn't. The tax limitation came and it is our commission's job to try to make the thing work. The power of appeal and the approval of the budget all fell in our lap.

Last year the general property tax was \$146,000,000 in Michigan. The general revenues of the state, including the money that the railroads and other utilities paid, and the sales tax, were around \$100,000,000, with the exception of the gasoline and weight tax, and that is around \$46,000,000. So the property tax was \$146,000,000 and so was the other, just about a fifty-fifty split. But government of all kinds is spending around 50,000,000 less than it did six or seven years ago.

The pinch—that is what I told the chairman of our committee—under the tax limitation will not come for another year or two in Michigan, due to the fact that the tremendous collection of the delinquent tax for by-gone years is far more than offsetting the current delinquency of the 1936 or 1937 tax. Our limitation is fifteen mills, but the supreme court has said that it does not include the rights of the cities under their charters except as they vote to put themselves under the fifteen mills, which several cities, Grand Rapids, Flint, Pontiac, Saginaw and Muskegon, have done.

When that happens, then, the city, school and the county all fall under the fifteen mills, and quite often the schools and the city want the whole fifteen mills. The county has to have income, and in fact, quite a considerable amount.

I am speaking to you not only as a member of the committee this morning, and as the chairman of a state tax commission—I have been through all these battles—but I am speaking also as one who has lived and whose family has lived in the rural districts of Michigan since the year 1841. That is quite a while, and the home land has never had a cent of delinquent taxes.

My neighbors have never felt the pinch of high taxes because practically all of the people in that township are either Scotch or Irish, neither of them very wasteful. At least, the Irish aren't anyway—the Scotch may be. When I say to you that our tax rate last year was \$7.60 in my school district, you will agree that my neighbors were justified in saying they were too high, and that is what they said—too high.

My colleague, Doyle, from New York, had the pleasure of serving in the same position I had for a year, that is, supervisor.

So when we say that we come to you with first-hand information this morning of how this thing works, we really have that information. I was the one who said to the chairman of the committee that Michigan was at the far-off end of this, so that we could point out all of the bad effects of limitation.

I can point out plenty of good effects. I thoroughly agree with everyone here who believes the same way as I do that you have to guarantee to the people that own property that there is a limit somewhere that you can't go beyond. If that limit is reasonable, all right, which it wasn't before the days of our fifteen mills. We believe it is now, although our constitution gives the three-fifths vote of the electors the right to go up as high as \$50 a thousand for a period of five years, and some have done that. But, generally speaking, if the tax level has dropped to the point wherein the supervisor uses reasonable judgment in the valuations, which is always a little bit less than he thinks is 100 per cent, why, there is nobody hurt. You can't put a supervisor or an assessor in jail for having very poor judgment, but you can put him there if he doesn't use the best judgment he has, can't you? That is quite a flexible thing.

We have to go down in the next week or two to view some property below the city of Detroit where it has been on the roll for \$10,000 an acre for quite a number of years, and it is first-class pasture. But it is \$10,000 an acre for that acreage bought by one of the great motor companies for a steel plant. So we pointed out to the people last year who wanted exemption from property taxes, "It is all right for you." But what are we going to do about this outfit down here that has 200 acres of \$10,000 an acre land? Are we going to take them off the roll?" And they, of course, didn't think of that. So if you point out a few horrible examples, as we call them, to the average fellow, he usually uses his head pretty well, especially if you treat him fairly.

I know there are some men representing the railroads in Michigan here in this room. They disagree with this question of fairness we have in Michigan. They don't like our formula. It is very unscientific. Some day I would like to have you all see a copy of it. It works because we always have one or two factors in there they can't catch us on.

So I think I am rather glad that we had this extra time this morning, because while my remarks are more or less rambling, they are to the point.

I want to call your attention, Mr. Chairman, to one more thing, and this is something that isn't on the program, but something you want to think about during the next year. We believe that the legislature of Michigan went further than it ever did before—and

I don't say that you haven't gone just as far—to clean up the delinquent tax mess. We had the same condition for years that you have had. We had \$200,000,000, perhaps, of delinquent taxes. Some of it was so much that the owner would be crazy if he ever paid it, due to special assessments.

The cities of Detroit, Grand Rapids, and four others are not under the state law for tax sale. They have their own sales. The legislative council appointed a committee on delinquent taxes. They travel the length of the state from Detroit to Holton, which is further from Detroit than we are right now. The committee came back with a set of delinquent tax laws which was perfect if they all passed, and they all did. I was opposed to some of them, but after I talked with the committee, I decided that my best job was to go out and support the committee, and I had to convince about a thousand supervisors I wasn't crazy at the same time the committee got that way.

We had a moratorium in 1932 and previous years. One-third payment had to be made. They set another moratorium in 1933, 1934, and 1935. The taxpayer could pay a tenth if he elected to. But he had to pay his 1936 tax in full in order to get on this second moratorium, and keep up his 1932 and previous years' payments. So he really had quite a load.

When the legislature adjourned they didn't agree on what they had done. So it fell upon the hands of Raymond W. Starr to interpret the law. The law may read so and so, but when the boys interpret it, that is what counts, and when the high court gets through with it, that is final. That is when the umpire says you are safe or out. We think he will say in this case they are safe.

On the first of next May they have a sale on all this stuff demanded, and the privilege of payment goes on sale. On the bulk of it nobody will pay it. You wouldn't pay \$36,000 taxes on a \$7,000 farm, would you? No. They are not as easy as that even up in Michigan. When that goes on sale there are no bidders. Then it goes to the new state land board created by the state consisting of three men to be appointed by the governor. They take all this stuff because it is redemption period. A year from next May they have what they call a scavenger sale. Under the Michigan law you can't bid less on the property than the current tax plus the penalty. But at this scavenger sale a year from next May the highest bidder gets it, and the original owner, the man who is supposed to have the equity in it has the privilege for a certain number of days to come in and take it at the price that the highest bidder bids. That is where we try to protect the owner.

For instance, here is a farmer down in Macomb County near Mt. Clemens. He paid \$11,000 taxes on sixty acres and had \$11,000 balance due. He wanted to know what to do. I said, "Do nothing. If you pay any more it is just too bad for you." He is the grand-

son of the man who took it away from the Indians. He would like to give it back to them, but the Indians aren't there.

So he will go to the sale, and I presume get a chance to buy that 60 acres at a loss of not less than twenty-five per cent of the assessed valuation. If he is a good friend of the supervisor, the assessment is probably low enough so that twenty-five per cent won't be very high. So he has paid for it twice in taxes besides what his grandfather paid.

He will have the right to pay a small sum of money to get the title back, clear of all taxes. That is fine for everybody but the rest of the taxpayers in Macomb County.

There is your picture. We think that barring some accident in the tax sale, in a year or two from now the question of delinquent taxes, so far as Michigan is concerned, will have nothing left but the current delinquency under the fifteen mills.

CHAIRMAN MAXWELL: The chairman is wondering if Mr. McPherson didn't have some experience as a young man in plowing a bull and breaking new ground.

The conference will be interrupted for another minute while a few additional available copies of this report are picked up.

MR. THOMAS: Professor Simpson, who is a member of this committee, and who participated in some of the difficulties in getting even the wording we got, was assigned to discuss the report. Since he was a member of the committee, he stated to me that it was his desire not to participate formally in this discussion. I thought the conference should know that Mr. Simpson is here and that he is not disinterested in this discussion.

JAMES W. MARTIN (Kentucky): The members of the committee seem to be monopolizing the discussion this morning, but I wanted to speak for the purpose of expressing my opinion on two matters in particular.

In the first place, I want to express special appreciation to Dean Thomas for doing most of the work that the committee was called on to do. Most of the thoughtfulness that you recognized in the report was his thinking, and the committee as a whole, I think, fully appreciates the significance of the thinking that has been done.

In the second place, I want to express emphatic endorsement, re-endorsement, shall I say, of the part of the committee's report that has to do with exemptions, not only from the point of view of the economic effects of exemptions on other taxpayers, but also from the point of view of the practical administrative difficulties that exemptions always introduce. It seems to me they are the curse of tax administration, and should be eliminated as far as is humanly possible, even to the extent, as far as I am concerned, of taxing public property. It seems to me that a strong case could be made

for taxing public property, and certainly doing away with exemptions should ultimately be the goal. I don't think they will, but it seems to me they should.

The over-all tax limitation seems to me personally to be definitely unsound, both on governmental grounds and on economic grounds. The committee report was not as emphatic on that as I should like to make it, and hence my personal expression on this particular point. The reasons for the viewpoint that I have expressed have been in part developed here, but there are other reasons, only one to which I would like to refer. Before referring to that reason, however, I ought to say, perhaps, that the extent to which over-all tax limitation is bad is more or less proportionate to the extent to which it is over-all. In other words, if there are numerous modifications and some elasticity in the over-all tax limitation, as for example in Michigan, then the over-all tax limitation is certainly not as bad as it is if it is really an over-all tax limitation hard and fast.

The facts in the actual practice make discussion such as I am about to suggest more or less misleading for those who have lived in tax limitation states and have learned the effects from actual observation of the tax limitation laws in operation, because most of them are not really over-all tax limitation laws. They have so many modifications that they are not as bad as they might be. Lord knows they are bad enough!

The economic consideration to which I made reference that seems to me to be overlooked is the fact that in any state there are varying desires on the part of the people for services of government. If people in one particular community wish to have sewerage and water service and fire service and police service, and the people in other parts of the state either cannot have it or do not wish to have it, then it seems to me that the state is acting contrary to public policy in setting a limit which makes it impossible, or well-nigh impossible, for them to do that, and if that limit is not set, then of course the over-all limit is not sufficient to have any influence in most of the state.

That is bolstered up also by the fact that the benefits which real property receive from the activity of government vary tremendously, ranging all the way from the benefits that you have on Manhattan Island, for example, in New York state, to nearly no benefits up in the northern part of New York in the wilds of the Adirondacks. The amount of benefit that real estate receives from the activities of government, as I say, is widely varying, and the amount of recoupment that government can make depends on the situation within the state.

The economic problem, therefore, of getting back some of what has been granted to the land owner is an entirely different problem in a large city from what it is out in the country. In a very large

city it is entirely different from what it is in a moderate-sized city; or in the downtown section of a large city as compared with the more sparsely populated residential section of the city.

For that reason, an over-all limitation that really limits will disable the cities in getting back some of the benefits that the cities themselves confer on the property owners, if the over-all limitation is really over-all. If there were no other reason for objection to the over-all limitation, and I think there are numerous other reasons, it seems to me that that consideration alone is sufficient, to say the least, to discourage us in making up our minds so suddenly on the subject.

ALFRED H. STONE (Mississippi): Mr. Chairman and Gentlemen, I am a member of the committee also, and I am adding to the monopoly. But I haven't any speech so I won't detain you but just a few minutes.

I am prompted to make the few suggestions I have in mind because of the statements that have been made as to the movement, or origin of the movement, back of the purposes that the committee has been considering, the homestead exemption, primarily.

The homestead exemption in Mississippi began in 1932 and 1933 with \$1,000. It wasn't the result of any propaganda at all. It wasn't the result of any outside movement, or really of any internal pressure except just that incident to the conditions that existed at that time. We were in the midst of a depression. Property had no value. Every newspaper in the state was running extra sheets. Country weeklies of four and six sheets ran as much as four to six or eight sheets of advertisements of property. This property included the homes of the people of the state. It wasn't confined to any particular group, wasn't confined to any particular area.

Somebody comes along in a situation of that kind, a member of the legislature, and says, "Well, we ought to do something for the people anyhow. We can't do much. It looks like the state is broke. So we will at least exempt the homesteads from taxation, some little amount." The amount agreed on at that time was \$1,000. It was never suggested that that exemption would include exemption from county and municipal taxes. It was in Mississippi a state exemption only, exemption from general advalorem tax. It didn't amount to very much to the individual. Our tax rate at that time was eight mills. It didn't do the individual very much good. You can see what that would mean. Eight mills on \$1,000 didn't amount to much. The experience with it, however, led to its increase, and at a special session of the legislature in 1935 that exemption was raised to \$2,500. There it stands now.

The effect of a \$2,500 exemption was to take about \$100,000,000 or \$110,000,000 worth of property off the roll. We know a great deal more about it now than we did at the beginning. We have

very accurate figures on it. It is administered by my department, the tax commission of the state, of which I am chairman. We know very definitely what it does. It hasn't injured the state particularly. But in proof of the fact that it has not injured the state, although it has not materially benefited the individual, I am also in a position to tell you that we have reduced the advalorem tax levy by one-half. The levy of eight mills has been reduced to four. We did that not by doing what some of the gentlemen here who discussed this matter have suggested, shifting that burden to other classes of property, from the property owner, for instance, to the tenant. We did it because in 1932 as an emergency measure, and simply and solely because of the very serious condition which confronted the general funds of our treasury at that time, we adopted as a temporary measure the retail sales tax. That also was turned over to my department to administer.

As a result of the retail sales tax, we were able to reduce our general property tax levy in 1934 to five mills and in 1935 to four mills. We let it stand, for reasons of prudence, in 1936, at eight, and in 1937 we reduced it to four again. We were able to do that, I might say by way of explanation, without any additional legislation. We were able to do it because, while the legislature fixes the maximum rate, there is also a provision in our law through which a committee of three men, the state auditor, the state treasurer, and the chairman of the state tax commission, may review the financial condition of the state on or before the first day of October each year, and if that committee of three men finds that the funds of the state are in such position that a recommendation of that kind is justified, they can recommend a reduction in the general tax rate to the governor. The governor at his discretion, by a proclamation, can make it effective.

In other words, we have reduced the rate from eight mills to four, and in 1937 we could have reduced it to two mills, or we could have reduced it to one except for a legislative innovation in that provision to the effect that that reduction shall not be more than fifty per cent of the amount fixed by law.

Our state is in a position to do that. I am not here advocating the homestead exemption and I am not here opposing the homestead exemption. As far as I am personally and officially concerned, as the administrator of state tax laws in Mississippi, it doesn't make any difference. If it is a good thing, if the psychology is good and the people get any comfort out of it, it is all right. We are in a position to go ahead without its having an effect on the state's finances.

I want to say also that we have gotten the state in shape through a retail sales tax and a combination of other taxes, which has been accepted as an entirely satisfactory and comfortable situation in Mississippi. I am not advocating it for anybody else, but when we

started out with it in 1932, when we began this discussion of this homestead exemption, we had only \$1,600 in the general fund of the state treasury—I don't mean \$16,000,000, or \$16,000; I mean \$1,600—and some \$6,000,000 of outstanding warrants which weren't worth much more than the paper on which they were written. School teachers' warrants were being discounted fifteen, twenty, twenty-five, thirty-five, and forty per cent, and we just didn't have any money in the state treasury.

At the same time we had a bad check law, and if a man wanted to get a check cashed at a hotel and the check came back, wasn't paid, you could put him in jail for it. At the same time the state treasury was issuing bad checks to its citizens by millions of dollars every day in the week.

Now we are down to where we have plenty of money in the treasury. We don't owe anything. Any state warrant on the treasury of Mississippi is just as good as a government bond of the United States, and if the people want to play with the homestead exemption, we are in a position to let them play with it.

CHAIRMAN MAXWELL: I am sure the very fine record Mississippi has made is due in large part to the fine administration of their tax laws by Mr. Stone as chairman of the state tax commission.

A. H. STONE: The gentleman here has just asked me a question, and it is so important that I would really like to trespass on your time for two seconds to answer it.

He asked me if we had paid those \$6,000,000 or \$7,000,000 of outstanding warrants. I want to say we certainly have, and if anybody has one I will guarantee to take it up before you leave the room.

CHAIRMAN MAXWELL: Gentlemen, let us be patient now. There are a number of people here who want to participate in this discussion. I am sure we will have time to get around to you if you will be patient.

PHILIP ZOERCHER (Indiana): Mr. Chairman and Members of the Conference, in 1932 Indiana passed what was known as a limitation law. This law provided that the limitation for townships should be \$1 a hundred and for cities and towns \$1.50. But there was a provision in the law that if there was an emergency the rate could be higher. All that is necessary is for the county tax adjustment board to declare that an emergency existed and that more money was needed. The supreme court in construing this law held that when the local board declared an emergency existed that was sufficient to justify the increase.

Of course, the old provision of the Indiana law, that ten or more taxpayers could appeal, still existed. In 1937 the tax limitation

was made \$1.25 in townships and \$2 for cities and towns, excluding the necessary levy for bonds or judgments and welfare purposes.

Then the tax adjustment board could not go beyond that. If they couldn't limit the rate to \$2 for cities and towns and \$1.25 for townships, it automatically referred the matter to the state board.

There is a further provision in the law that has to do with the word "emergency". As it is now defined by the law it covers only cases of fire, flood, pestilence and so forth. Those are the only cases in which there can be an excess. Then there is also a provision that before any bonds can be issued fifty or more owners of real estate have to sign a petition for bonds or other certificates of indebtedness, and then if fifty-one owners of real estate remonstrate against that, why, it just stops it for a whole year.

So you can readily see that the matter now is absolutely in control of the taxpayers if they are active and do their part. Of course, we realize, from the position that Indiana has taken, that a fixed limitation can't apply, because we don't have in every community the same amount of taxable property according to the population and according to the needs.

Then there is another point that the law brings out, that the amount levied, collected and expended shall be the amount fixed in the budget. Heretofore, during 1935 and 1936, one year, we had sixteen hundred and seventy-eight additional appropriations, and the next year one more. But now under the law they can't have these additional appropriations, unless some of these unusual circumstances arise that have been pointed out. I think that as far as that is concerned this coming year will tell more of what the actual practice is going to be, what the effect will be, but we believe that it is going to be to the interests of the taxpayers of the state.

Another thing, in 1932 when the limitation was fixed, there was an emergency on all the units but not on the state. They fixed the state rate at fifteen cents on \$100. Under our constitution the state cannot incur any indebtedness. She has to pay as she goes. With the reduction in the valuation of the property it would have taken a levy of thirty-five cents on \$100, so you can readily see that when the administration came in on the first of March, 1933, they were faced with a condition and something had to be done. We sent somebody down to Mississippi, but we didn't follow the Mississippi plan of retail sales tax. We took the plan of a gross income tax. And the first \$1,000 was exempt. I think that is a whole lot more equitable—not criticizing our good friend from Mississippi.

Here is a man who has five or six children and whose income may be not more than \$1,000 a year. Here is another man who may have an income of \$20,000 and may only have one child. This poor man over here pays three cents on every dollar's worth of merchandise that he buys. You can readily see the injustice of the

burden on the poor man and then this small burden that is on the other fellow.

Now under the gross income tax, this poor man doesn't pay any, because on the first thousand dollars of income he doesn't pay. This fellow with his \$20,000 pays on \$19,000 at the rate of one per cent. So you can readily see why I believe that our plan is more equitable. We haven't any debts. The state has paid as she has gone, and with a large amount in our budget we are contributing \$700 to every school unit in the state of Indiana.

CHAIRMAN MAXWELL: The chair gets the impression that the Indiana plan is still going strong.

JACK M. GEOFFROY (Kansas): I just want to ask Dean Thomas one question regarding a matter which I feel sure his committee considered in preparing its report.

There is a question, Dean Thomas, which arose constantly in Kansas during the recent discussion there of homestead tax exemption. In those states which have adopted such exemption, how extensive has been the practice of building and loan and other similar associations in shifting the type of their sales or rental contracts, so that their property takes a maximum credit under the exemptions?

That was considered, I presume, in your discussion, Mr. Thomas?

RAYMOND D. THOMAS: The committee has no data on that particular point. We have been so much concerned and busy with other matters we have not been able to get deeply into this thing.

F. WARREN RAGGIO (Louisiana): Gentlemen, if I were talking to an audience from Louisiana which is predominated with names like Forntenot, Couvillion, Mouton, or Quinson I would greet them like this, "Bon jour, mon ami! Comment vous portezvous," but since I am in an audience that is predominated by names like Jones, Smith and Brown, I would say this, Gentlemen, I am glad to be here at this conference.

I would like to say we have in the state of Louisiana a homestead exemption of \$2,000. That means \$2,000 on everything. That is ad valorem property tax.

By way of explanation, I would like to state that Louisiana operates under the Napoleonic code. No other state in the union does. The tax commission, of which I am chairman, administers the homestead exemption law. We check claims for exemptions very carefully.

All bona fide property owners in the state, whoever they may be, are entitled to the homestead exemption.

By way of illustration, in the parish which I hail from the entire state tax is \$21,000. This year the state of Louisiana sent to my

parish \$67,000. In other words, more than twice as much was sent to the parish as the parish paid to the state.

That happens in all of our parishes. We believe that the homestead exemption is one of the three greatest laws that the state of Louisiana has ever enacted. We believe that it is a godsend to the people in the poorer parishes of the state. We base that theory upon the thought that every man's home is his castle. A man is entitled to a home. If he cannot pay the tax, why should he be burdened or his property be forced to be sold?

This year, through our office, there will be nearly 200,000 homestead exemptions in the state, more than 20,000 over last year. Based upon an assessment average of twenty-five mills, that means \$5,000,000 the state of Louisiana returns to the property owners in the state.

As I said before, it is working in our state, and I think it would be a good idea if it could be adopted in all the various states. Of course, understand, we know that our state, outside the city of New Orleans, is a sparsely settled state, and of course we also know that we have as much rural area as Mississippi, if not more.

We know that our law is a good one as far as our state is concerned. We also have an exemption that I heard quite a lengthy paper about and enjoyed very much in New York last week, by Mr. Miller. It is a new thing in our state. We are trying it out. I hope it works, but I believe it is going to have to be improved upon a little. That is the exemption to industries. This year, before the year is over, we will have exempted from all taxation, property, personal, and such as that, industries to the amount of about \$50,000,000, and when you stop to consider that the South is being forced to invite industries here, we believe in the end the good will overcome the bad.

Also all fraternal organizations, whenever they are benevolent, are exempted. We exempt household goods up to the amount of \$1,000. We exempt farm implements up to the amount of \$500. We exempt automobiles from taxation and we exempt all livestock in the state of Louisiana; also all religious organizations, hospitals and sanitariums, where they do a great part of their work for charity.

In conclusion, I would like to say something, to which you might say, "Well, that bird is from Louisiana. He is stuck on his state, loves his state." I do. We think the three greatest things the state of Louisiana has ever done were done by the greatest statesman the world has ever produced. I know I am going to get a laugh, but we believe that man is none other than our illustrious senator, Huey P. Long. We think he was one of the most dynamic personalities the South has ever produced.

At this time, if you don't mind, I will give you an illustration of how he operated. At one time we were going to have a big cele-

bration in Baton Rouge. It happened on the day that one of the largest circuses in the world was supposed to be in Louisiana, and we knew that the circus would possibly take part of our crowd. So the senator rang circus headquarters in New York, and talked to the president and owner of this circus. I will call him Mr. Brown. He didn't call him Mr. Brown. A characteristic of the senator was to call everybody by his first name and everybody called him by his first name.

He said, "John, your circus is going to be in Baton Rouge on such and such a date. It conflicts with a big celebration we are going to have in Louisiana. I would like for you to change that date."

The circus owner said, "That is impossible, Governor, we can't change the date."

The governor said, "We would like to have you change it."

He said, "Well, for your information, we are not going to change the date, because that is in our itinerary and it can't be changed."

The governor smiled and said, "Mr. Brown, there is a state law in Louisiana that requires all livestock to be dipped when it comes into the state and when it goes out. For your information I would like to ask you a question. Did you ever try to dip a tiger?"

CHAIRMAN MAXWELL: If time on our schedule permitted, I would like to ask the gentleman from Louisiana where he does get his money from.

MR. RAGGIO: I have also been in the real estate business, so I will apologize for my boasting along this line. We have in the state of Louisiana the largest oil fields in proportion to area of any state in the union. We also have more salt mines than any state in the union. Also in the state of Louisiana we at one time had the second largest sawmill in the United States. We also have in the state of Louisiana sulphur and gravel and many other kinds of natural resources that you might wish. We tax these to get revenue.

Sulphur we tax \$2 a ton. We assess salt \$1 a ton. We assess gravel about \$1 a ton. And we assess something else that you have all heard about, no doubt. It caused quite a stir in the state of Louisiana about five years ago. We put a one cent a barrel tax on oil. I know you all know about that case.

We also have in Louisiana, of course, an income tax based upon the federal government's. We have no objection to exempting federal employees. We exempt them. We have also a corporation franchise tax, and we have a luxury tax. That luxury tax in the state of Louisiana means just exactly what the word implies. We tax only luxuries. And by the way, we have a whiskey tax. We also have a cigarette tax.

In other words, we tax the fellow who can pay and take it off the backs of those who cannot pay.

VON T. ELLSWORTH (California): During the remarks that have been directed to this important subject I have been looking forward to the prospect of some being dropped as to the effect of the limitation on the taxpayers. In other words, what is the effect upon the concern of the taxpayers and the activities which they will manifest in their government due to limitation?

It has been my good fortune during the last ten years, in fact in excess of that amount of time, to be directly concerned with agricultural interests and rural thought in California in so far as taxation is concerned. In 1927 we enacted a county budget law requiring that the budgets of local governments be presented to the taxpayers and that opportunity be given them for hearing. We took that budget law really seriously and looked upon the local budget as being the steering wheel, if you will, the accelerator and the brakes of this vehicle, government. For years we enlisted the support and stimulated interest on the part of local people throughout the state, and I can truthfully and sincerely and emphatically say from first-hand information that that interest did grow with time, and that the number of intelligent, substantial, worthwhile citizens who were willing to give liberally of their time in the study of governmental problems increased.

Those of you who are familiar with the change in the tax system in the state of California in 1933 will recall that as a part of that there was enacted an expenditure limitation law. The point I would like to emphasize is this: that in 1933 the interest manifested in that state dropped off materially with the enactment of that limitation law, whereas prior to that time, as I have said, numerous citizens would give of their time in studying what to them were dry statistics, and in making reports and presentations before their spending bodies.

Following that date, it seemed to them that there was no need for such activity. I could show you reams of correspondence where people who had attended the hearings and had taken part on local committees, expressed themselves along that line, that there was no further need for such activity.

One of the characteristics of our state in recent years is a material influx in the population from some of the mid-western states; those who need to absorb a lot of sunshine at minimum cost come there in rather large numbers. We are rather fearful as time goes on that that class of citizenry will dominate our state. That thought, coupled with the one which I previously expressed, that the limitation law does lull to sleep or does serve as a mental anaesthetic to those who would otherwise be active, gives us reason for deep concern.

I had hoped that those of you who had experience in other states with the limitation laws of different types would have reflected your observations along that line. That is mine, and I have had considerable opportunity to make those observations.

The second point that seemed to me might be made is that we might consider our limitation law, or its application, as an emergency matter, that probably a limitation law would be advisable at a time of change in the tax system, whereas otherwise it would not be advisable as a permanent measure.

The latter, it seems to me, likewise has not been given as much consideration as it might.

CHAIRMAN MAXWELL: The chair had the pleasure of a rather comprehensive visit to the state of California recently, and was shown many of their interesting points. California has at least its full share of superlatives—altitudes from 150 feet below sea level in the rich Imperial Valley to 10,000 feet mountain peaks, the largest prune orchards, the largest vineyards, the largest peach orchards, the largest lettuce farms in the world, and of course, the largest trees in the world.

Really, the most thrilling thing, I think, was the giant redwoods. When experiencing the ecstasy and thrill of that great sight I told our host that if he would just take me to Mae West I would come back home thoroughly satisfied.

VON T. ELLSWORTH: And the largest bluffs, Mr. Chairman.

CHAIRMAN MAXWELL: The largest bluffs also. Amendment accepted.

R. K. SEIDMAN (Tennessee): Mr. Chairman, Ladies and Gentlemen, now that all the states have sold themselves respectively to you, I am going to get away from selling you the state and sell you an idea.

There is no doubt in my mind as well as there is no doubt in your minds that the general property tax itself has been condemned and is archaic. So that we might just as well attack the problem from that angle, eliminating for the time being the question of limitations, exemptions, and so forth.

I don't believe anyone in this room has ever heard of a wealthy man defaulting in his property tax. You might ask yourselves why, and I will answer that question for you. It isn't because he pays his property tax. It is because statistics, tests and researches have shown that the wealthy individual owns proportionately less of the real property than any other group or type of citizen in the country. Therefore, our problem becomes one of basic realities. We are looking at a property tax in a biased fashion, I will admit. But you have to remember that you are very vulnerable, to the

extent that yours is a tangible piece of property, something that can be seen, something you cannot hide from the tax collector.

Therefore, our problem should not be the reduction of taxation, or the elimination, or the exemption. It should be directed entirely to the proposition of making business within each state pay its proportionate share of the tax burden. You know as well as I do that many partnerships and individuals do not pay as much as their corporate competitors do, even though their capital structure and investment are the same, and they are in direct competition with the other individuals.

It reminds me of the proposition that encompassed Columbus when he set forth. He didn't know where he was going, when he arrived he didn't know where he was, and when he got back to Spain he didn't know where he had been. And he did it all on borrowed money. That is exactly the position we are in in the question of taxation in our respective states.

I say that there is no need, basically, for a real property tax. I say that if you get down to a sound tax structure, you will find that all you need is one sound tax. Now mind you, I am not a single-taxer, but if you will get one sound business tax levied by the state, you will in all probability eliminate your property tax.

If there is a property tax to be paid, it should be levied and paid at the situs, rather than by the state. The benefits accruing to the property, and the benefits bestowed upon the property are those bestowed by the situs—the situs and the local government. The state pays a very minor part in that benefit.

Therefore, I say to you that there is a general proposition in law, that if we allow one exception, we undermine the entire structure of the law itself, and you have a proposition where you tax either all the property, part of the property, or none of the property, and none of those can be looked upon with any great favor.

If we are going to eliminate homesteads, or if we are going to eliminate charitable property, or if we are going to set an over-all valuation, we are tying ourselves up with a problem of politics, and with it our tax structure is bound to fall.

The limitation can come in another form. You folks are imbued with civic pride and you go out and demand of your government all sorts of services without looking at the tax cost. If you will limit your demands on government, if you will direct your attention to having business pay its proportion of the tax, and if you will see that you as property owners have the control of the voting on property tax issues, then I think you will conquer your problem of real estate taxation.

I say that this usually is a long-range program, for what you can do right now is not to go to your respective commissions or governors and talk to them in the terms of getting the homestead deductions, or an over-all rate, but talk to them in the terms of

getting a proportionate tax levied on everyone in the community, and not just burdening the real estate owner with his disproportionate share of the tax.

ARTHUR F. POTTER (Connecticut): I should like to ask Dean Thomas a question, if I may, and that is, what was the amount of time given by the committee in the study of the incidence of the homestead tax exemption, and what effect the homestead tax exemption has on the present and future owner of real estate, and the effect if any upon the renter, present and future, of non-homestead tax-exempt real estate?

I have seen there are three schools in regard to this. The first school says that the homestead exemption is entirely capitalized. The second school says it is not capitalized to any extent and each future owner gets a full benefit of exemption. The third school says that it is partly capitalized and partly non-capitalized. But from this third school I have never heard in what proportions it is capitalized and non-capitalized.

I would like an answer to that.

RAYMOND D. THOMAS: The committee recognizes the need for data on the points mentioned by the gentleman, but we have not made any studies. We hope that if the committee is continued that studies of that kind may be made.

CHAIRMAN MAXWELL: Is further discussion desired? If not, we have had a very interesting range of discussion on these important problems, and I am sure the conference feels indebted to those who have contributed to it.

If there is nothing further this morning, Mr. Query asked that the announcement be repeated that there will be a meeting of the association of states on bank taxation at four-thirty in Parlor F. It is desired that everyone interested in the matter of taxation of national banks by states attend.

If there is nothing further, the conference will stand adjourned.

FIFTH SESSION

TUESDAY, OCTOBER 26, 1937, 2:30 P. M.

SIMEON E. LELAND (Illinois): The hour has arrived when we must welcome some of our late arrivals, including Senator Edmonds. We are glad to welcome him here today and know that he is on tap, along with Blaine Moore, who came in late, and some of the others who haven't attended previous sessions. We want them to know we are glad to have them. They are a little different from some of us. Some of us appear and disappear, but they come and stay.

The first order of business this afternoon is the regular afternoon list of announcements by the secretary.

SECRETARY W. G. QUERY: The most important announcement I have to make is regarding the resolutions committee members. Only ten states have reported a name for the committee, and I hope that in order that the resolutions already submitted may be turned over to the committee, before the evening session all of the delegations will give the name of the resolutions committee member.

I would like to announce again that the association of states on bank taxation will hold a meeting in Parlor F today at four-thirty.

It is gratifying to know that the registration at the conference is approaching 500. We will probably reach 500 during the afternoon.

MR. LELAND: I would like to announce that the Illinois delegation will meet over in this corner of the room (indicating) after this session and select their representative for the resolutions committee. There are three other corners available for three other states.

The afternoon session is devoted to some very interesting problems of fiscal policy, and the session is under the general chairmanship of Mr. Royal B. Cushing, of Chicago. Mr. Cushing has been a long and regular attendant at these meetings, and like most all of our presiding officers, needs no introduction to this association.

It is with pleasure that I turn the gavel over to him.

ROYAL B. CUSHING, presiding.

CHAIRMAN CUSHING: We have a heavy program this afternoon, and I am sure the occasion does not call for preliminary remarks of any length from me.

The subject of the first paper deals with the shifting of taxes, and this certainly is a very interesting and live topic. We all are strong believers in our government and we all are strong believers in taxes, provided the other fellow pays them. That is where the tax shifting comes in. There is a joker quite often in the tax laws that are levied.

After the taxes are extended and the bills paid, you find very often that it is the ultimate consumer that is paying the tax.

I think there is much to be said in favor of the sales tax as an open tax where the taxpayer, the real taxpayer, recognizes that he is paying the tax and is tax-conscious. The ordinary tenant in the apartment house pays high taxes, but he doesn't know it. It comes in the rental that the landlord collects from him. We are very glad to welcome on this occasion the speaker who is to present this subject. He is an economist well known throughout the country, particularly well acquainted with and well known by our elder statesmen in the National Tax Association. A number of years ago he presented an able paper before one of our conferences.

I take pleasure in introducing Professor Jacob H. Hollander, professor of political economy at Johns Hopkins University, who will discuss this subject, "An Economist's Examination of the Theory of Tax Shifting as Exemplified by the Windfall tax."

THE WINDFALL TAX

I do not propose to restate (1) the legislative history; (2) the judicial experience; (3) the fiscal result of "the windfall tax." These are the facts of record, familiar to a company such as this. My purpose is to discuss briefly the relation of the device to the body of accredited fiscal doctrine and to the fabric of federal revenue provision.

The theory of our national tax system in the generation since large recourse was had to income taxation has been contribution according to ability as evidenced by money income. The "system"—if such violent use of the term may be had—has been deflected and distorted. Fiscal requirement, political expediency, group pressure, social idealism, so-called wealth equalization have made a motley in fact of a simple venerated concept in theory; every citizen shall contribute to the support of government according to his economic capacity. Like the famous visit of Mary's little lamb to Pittsburgh, once "white as snow"—now "look at the damn thing!"

And yet, unless we are to scuttle all fiscal theory, deny place to what Professor Ross years ago urged as "the fifth canon of taxation," and give defeatist assent to a goose-plucking-and-minimum-squawk practice, the criterion of criticism must remain conformity to or neglect of the principle of ability.

Income—as the evidence of ability—is either, what for lack of better terms may be awkwardly designated as “calculated” or “fortuitous”. Calculated income is the net receipt from wages and profits and the increment from productive possession. Its obligation in a tax fabric, fashioned upon the principle of ability, is a progressive income tax—this with full admission of the shortcomings due to legislative defect, administrative ineptitude and, less abusively, to the frustration of an imperfect psychology.

This naive program is disturbed by the recurrence of fortuitous income. From time to time the taxpayer comes into ownership of additional income standing in no relation to effort, enterprise or prior possession. Of this general type are collateral inheritances, excess profits, capital gains. In each such case the taxpayer comes into possession of an unanticipated increment. His economic capacity has been suddenly augmented in excess of any normal return for related effort or intelligence. The state—speaking prose, perhaps, without knowing it—has imposed a super-charge upon such augmentation, and fiscal theory has concurred in at least the principle of this procedure as in conformity with the doctrine of ability.

The more complicated situation is presented when the state, undertaking to impose an excise upon a manufactured article of consumption, assesses and collects the tax from the manufacturer or “processor”, in the expectation that it will be shifted to the consumer, and then has to face the annulment of the tax, partially operative, by judicial determination.

The simplest case is presented when the tax is assessed upon and paid by the processor to the state, and is then shifted, in a higher price, to the consumer. Waiving the refinements of elasticity of demand, the incidence of the excise is then, as designed, upon the consumer. In the event of annulment, his plight is that of one who has paid an illegal tax, with a resultant claim by the consumer for refund, either directly or through the “shifter”—in this case the processor.

If the excise be absorbed, wholly or in part, by the processor, in order to avert reduced consumer demand or to conserve the economy of larger scale production, I can see no other mode than administrative determination for establishing the fractions of incidence and the corresponding titles to refund. It may be, however—and here we come somewhat nearer to realities—that the tax, although shifted in a higher price to the consumer, has not been paid over to the state by the processor or has been paid over with protective legal reservation. In such event the processor, save in so far as he may have been unfavorably affected by elasticity of demand, will have come into possession—thanks to legislative error and judicial correction—of an unanticipated and an unmerited in-

crement. From the standpoint of economic capacity, it is a fortuitous income—and a not very respectable one at that!

The idealistic solution—the excise having been annulled—would be for the processor to refund to the consumer the tax which he had collected and which he had not yet paid over, less such costs as he himself may have, directly or indirectly, borne.

Voluntary reimbursement is, however, a fanciful assumption, capricious and occasional in operation if attempted. The normal procedure would be legislative action mulcting the processor who had shifted and not paid over the tax, to the extent that his net gains, administratively determined, were swollen by such action.

It seems to me, therefore, that “the windfall tax” is sound in principle, and in conformity both with fiscal theory and with our own tax practice.

In two particulars this estimate must be modified: In the first place, the consumer will have borne and the treasury will have received an extra-legal excise. In the second place, the intent of the tax assumes such a degree of administrative nicety, in order to conform with fiscal principles, that its practicability may reasonably be challenged.

In short, we are face to face with an old bogey: “Sound in theory; crude in practice.”

CHAIRMAN CUSHING: Professor Hollander certainly did not even reach the limit of his time. He gave us a great deal in a very short time.

The next subject scheduled is, “Implications of Federal Finance for State Revenue Systems.” I don’t know just what the implications of that subject are, but I am willing to leave it to the speaker who is to address us.

I take pleasure in introducing Professor Herbert D. Simpson, of the School of Commerce of Northwestern University.

SOME IMPLICATIONS OF FEDERAL FINANCIAL POLICIES

HERBERT D. SIMPSON

Professor of Public Finance
Northwestern University

Two years ago, at our meeting in Oklahoma City, Professor Hahne read a paper on the “repercussions” of federal taxation. A year ago we moved a step nearer to Washington, meeting in Indianapolis, and Professor Fairchild discussed the “impacts” of federal taxation. This year, moving as near to Washington perhaps as we shall ever get, I am discussing the “implications” of federal policies. As a matter of fact, out in Oklahoma they are

still having repercussions, and in Indiana they still feel the impacts of federal policies; and so all over the country we are experiencing a train of impacts, repercussions, and implications which we will have occasion to discuss for a long time to come.

I was unable to attend the conference last year and did not learn of Professor Fairchild's paper until some time later. When I did, I was so impressed with the clearness of his analysis and the convincingness of his statement that I scarcely had the presumption to undertake to discuss the subject further. In venturing to do so, I am virtually, as in an old-fashioned sermon, taking Professor Fairchild's paper as my "text". I shall therefore only put forward briefly a few further implications of present policy and then draw the "moral" which seems to emerge from them—in the assurance that if I can start with a sound *text* and end with a sound *moral*, it may perhaps not be a matter of great concern what I say in the interim.

What I want to say in the interim is:

I. STATE AND LOCAL GOVERNMENTS WILL HAVE TO DEPEND
MORE THAN EVER UPON SALES TAXES
AND PROPERTY TAXES

In the first place, federal policies have substantially increased the responsibilities of the state governments, particularly in the field of social security. At the same time the federal government has largely absorbed any potential areas of increased revenues for the states in three fields, namely: income taxation, estate and inheritance taxes, and corporation taxes, particularly through the undistributed profits tax. The one area of income taxation which many of us had hoped might afford a kind of reserve for state government needs was the area of so-called middle brackets, where the curve of federal rates has always thus far left a relative depression. But according to conversations and reports coming from the treasury department, it appears to be the intention of the department to exploit this remaining area in the next revision of the income tax. And of course, if Senator LaFollette's proposals should be adopted, even the lower income brackets will be further exploited by the federal government.

This would seem to imply that the states are going to have to lean more heavily than ever upon the one substantial field of revenue still left to them, namely, the sales tax. Most economists have looked upon the general sales tax as an undesirable importation from European and Oriental countries—a tax that is not based on ability, benefit, or on any other accepted principle of equity in the distribution of public burdens. Its one merit is its capacity to produce enormous revenues, regardless of the condition of the taxpayers who pay it. As such, it affords a valuable source

of revenue in times of emergency, and throughout the recent depression it has served this emergency purpose admirably. Many of us had hoped that with the passing of the emergency, it might be possible to look forward to a gradual relinquishment of this form of taxation. *Any such hopes have been greatly diminished by federal policies of the past few years.*

In the field of municipal and local government, most students have recognized the enormous concentration of taxes upon real estate. Professor Fairchild made some pungent comments on that subject last year, with which I am fully in agreement. I take no stock in the movement emanating from Florida and elsewhere for the complete abandonment of property taxes—even if such a thing were possible. Property is an index of ability, a legitimate basis for taxation, and one that has demonstrated a high degree of merit.

But nevertheless, most tax students have deplored the pyramiding of public burdens upon this one category of taxable capacity, not only from the standpoint of fairness to property owners, but from the standpoint of the financial stability of local governments. Most of us had hoped for some gradual lessening of property taxes through the transfer of a portion of the burden to income and other forms of taxation.

Four years ago, at a meeting of the Tax Policy League in Philadelphia, I presented figures showing that, on the basis of existing taxes and assuming a return to a level of prosperity equivalent to that of 1926, it would be entirely possible, if the states wished to do so, to shift approximately one-third of total property taxes to income taxation, without hardship to anyone. I prepared a chart—a beautiful chart—of taxes and income, illustrating this possibility. That chart still hangs on the walls of my study, but it hangs like the harp that hung “on Tara’s walls,” after its soul was dead. The soul of my chart is dead, because, after the developments of the past four years, there is now no possibility of shifting one-third of the burden of property taxes to income taxation—or to any other form of taxation that is now discernible.

II. THIS DEVELOPMENT HAS IN TURN GIVEN POWERFUL IMPETUS TO MOVEMENTS FOR TAX LIMITATION, HOMESTEAD EXEMPTION, AND OTHER ARBITRARY PROPERTY TAX RESTRICTIONS

In the second place, the realization of this situation by property-owners and the apparent hopelessness of securing any material reduction in property taxes through resort to other forms of revenue has given a powerful impetus to movements for tax limitation, homestead exemption, and other arbitrary restrictions upon the amount of property taxation. In the past, those of us who

have looked upon these movements as unwise have always been able to point out that there were more orderly and constructive methods for attaining some reduction of property taxes. It is to be hoped that the committee of the National Tax Association on tax limitations will throw more light on this subject than I am able to do. But in the meantime I will only observe *that developments of the past few years have greatly increased the difficulty of making a rational or convincing answer to the tax limitation movement.*

III. FEDERAL SUBSIDIES HAVE PROVIDED A GENERAL ALIBI FOR CORRUPT AND INCOMPETENT STATE AND LOCAL GOVERNMENTS

In the third place, federal subsidies have provided a general alibi for corrupt and incompetent state and local governments. The decade preceding the depression was a period of conspicuous governmental incompetence and sometimes of spectacular extravagance on the part of political organizations in control of municipal governments. Under the conditions of general prosperity, public opinion was indifferent and the possibilities of reform of any kind were very limited.

With the onset of the depression it was easy to foresee that these extravagant and corrupt governments were going to plunge their communities into various degrees of bankruptcy. Some of us had anticipated that this at last would force upon the citizens of these communities some realization of the character of their governments and develop a resentment against the political organizations responsible that might make some constructive reforms possible. The liberal subsidies and distributions of the federal government changed all this; and well-intended as they were, they actually provided a wide-open alibi for scores of corrupt political organizations who had been plundering their various communities for years, and who were thereby enabled to continue to plunder them. Professor Lutz said, before the American Economic Association back in 1933: "As long as hope remains that the federal government will provide a financial cushion against the results of corrupt and incompetent local government, there can be no prospect of securing the administrative and fiscal reforms which are essential."

His diagnosis proved only too accurate. Federal distributions *have* provided a "financial cushion against the results of corrupt and incompetent government." And it would appear that as long as present subsidies and distributions continue, they will continue to provide immunity from the results and responsibilities of local misgovernment. Political organizations in control of municipal governments can, like the prodigal son, continue to "waste their substance in riotous living," and when times get hard, run home for the

"fatted calf." But underneath whatever humor there may be in the situation lies the sober fact that all this means a *distinct lessening of that political responsibility and accountability of public officials to their citizens which constitutes the very essence of democratic government.*

IV. FEDERAL DOMINATION OF STATE AND LOCAL GOVERNMENTS

In the fourth place, the dependence of state and local governments upon the federal government for rescue from the results of their own misgovernment and for securing as liberal a share as possible of the federal subsidies and distributions, has placed the federal government in the position of dominating state and local governments throughout wide areas of governmental policy. And this is not merely administrative centralization. We have had in European countries, even before the present period of gangster governments in Europe, examples of governments with a degree of administrative centralization far beyond anything we have in our federal government today. The speaker will frankly admit that he has always believed, and still believes in general, in a larger degree of centralization in both state and federal government; so that whatever prejudices he may have are all on the side of administrative centralization.

But this is not merely administrative centralization. It is a fundamentally different process. This federal domination is not exercised through the structural agencies of government, but through the weight of economic and political pressure in the form of enormous financial distributions. This means a kind of extra-legal process, in which the procedure may be entirely legal, but the impact and influence are almost entirely economic and political.

The political status of state and local officials has come to depend largely not on appeals to the approval of their own citizens or on the competent discharge of their state and local functions, but on their ability to "bring home the bacon" from Washington. A good part of the time of state and local officials and even of members of our legislature, in Illinois, has been spent on the Capitol Limited. Now one need not be cynical or particularly sophisticated to understand that this means a considerable *subordination of state and local officials to departmental and administrative heads at Washington.*

The conditions may make this necessary and the results obtained may not all be undesirable. But nevertheless this is not a relationship set up in the structure of state government or contemplated in the constitutional processes of state and local government. We did not elect Governor Horner and Mayor Kelly as "delegates" to Washington; yet they have come to occupy in some respects much the status of the territorial delegates from Hawaii and the Philippines.

I have elsewhere compared this to the "carpet-bag" governments set up in the South in the period following the Civil War. Of course, the conditions and circumstances were entirely different, yet there are some essentially similar characteristics. In that unfortunate experience we had the domination of state governments by political organizations, sustained by federal patronage, on the one hand, and by a newly enfranchised class of irresponsible voters, on the other hand. In our present situation, likewise, we have political organizations, which—perhaps unavoidably—have come to lean heavily upon federal support for their continuance in office. We have not disfranchised any class and have not formally enfranchised any new class of the population. But we *have come dangerously near to "enfranchising" a new class of vested interests in the form of those large groups who have for years been recipients of relief or other liberal distributions from the federal government, and whose financial interest lies therefore in the continuance of these benefits.*

In any case, call it by what name we will, the result is a constant bartering of civic independence and of state and local autonomy in return for federal distributions. Now again, the exigencies may justify this kind of bartering. Esau was pretty hungry when he sold his birthright for a mess of pottage, and some of our governors and mayors have been pretty "hungry". But Esau was never able thereafter to recover his birthright from the wily Jacob; and it may be conjectured that we are going to encounter some of the difficulties that Esau lived to regret.

It is for these reasons that I have said that our present type of federal domination differs fundamentally from a mere administrative centralization.

Now, it seems to me that one implication emerges from all this with considerable clearness. The leader of a labor organization in Chicago asserted at a public hearing a few weeks ago that when our Illinois Relief Administration declined to adopt a particular policy with regard to striking workmen, the head of his organization in Washington immediately saw the head of the federal department concerned with this type of relief, and that within twenty-four hours a representative from the federal department was in Chicago demanding that the state agency adopt the policy desired. Whether this statement was accurate in its detail I have not been able to ascertain. The sequel seemed to indicate that it was substantially so. Whether it was or not, we are all familiar with the effective pressure brought by federal departments for the adoption, by state and local agencies, of particular policies which they—perhaps sincerely enough—believe to be the right ones.

Now all this is presumably entirely legal and constitutional. We elect members of the congress. Congress votes certain appropriations and authorizes the president to allocate them at his discretion. The president appoints the heads of federal agencies, who in turn

exercise wide discretion in their policies of allocating these distributions. It is all within the powers conferred by our democratic constitution. But the hiatus between the original exercise of the suffrage and the final distribution of these billions of dollars is so wide that it is scarcely possible to discover any connection between them.

The result is that these distributions, however honestly and altruistically they may be made, almost unavoidably follow the channels of group and party organization and processes rather than any of the ordinary legislative processes of government. Moreover, the groups who are beneficiaries of these policies appear to have a remarkable capacity for developing political solidarity with the organization able to dispense them. And so we come to substitute this group and party organization and party processes, in various extra-legal ways, in place of the ordinary structural processes of government.

But the substitution of party process for governmental processes is the essence of fascism. Fascism is not the old-fashioned military dictatorship that rested on a victorious army or a pretorian guard. It is a closely knit party, with the aid of party paraphernalia and national pageantry, so firmly integrated that it can be dominated by a few leaders at the top, and powerful enough to eventually supplant the regular machinery of government. This was the technique originally developed by Lenin in the organization of the Soviet Party in Russia. It is commonly referred to by students of political science as the "technique" of the Russian Revolution. It was deliberately copied by Mussolini in his early campaigns in Italy, and frankly imitated in turn by Hitler in Germany.

Now I am not trying to build up some sensational interpretation. I do not believe that we are heading into Fascism or Hitlerism or Bolshevism. I believe that we have in our racial heritage and national tradition elements that will somehow make such an outcome impossible. But nevertheless one who makes any honest effort to comprehend the significance of what is going on around us can scarcely avoid the implication that in the extent to which we have substituted party processes and the political pressure of federal largesses for the regular processes of government, we have traveled a long way in the direction of the party governments in the totalitarian states of Europe.

CONCLUSION

Now, what does this mean in terms of policy? It means, in homely, practical terms, that those of us who share this view must work against the further relinquishment of functions, and of the revenues to support them, to the federal government; that we must not allow the states to be further submerged under the sheer weight of federal subsidies; that we must work for the vigorous assumption

of the responsibilities of state and municipal government, even if this means temporarily increased taxation of our own communities.

For those who believe that the state governments no longer serve any useful purpose and that most of their functions could better be centralized in the federal government, there are considerations that can be urged in support of this view. But in that case we should proceed through constitutional and orderly methods to bring about the necessary changes in our governmental structure. We should not allow the structure of state government merely to be eroded away by extra-legal forms of political pressure and federal domination. Of all things, we must not be caught in the position of demolishing the one structure until we have erected an alternative structure to take its place.

CHAIRMAN CUSHING: I hesitate to call on the next speaker. After Mr. Simpson's endorsement of everything that Professor Fairchild said a year ago, I am afraid he may not speak up with firm conviction and acclaim. But Professor Fairchild needs no introduction here—a former president of the association. We are going to give him a chance to discuss both of the papers that have been presented. After the ex-president has discussed them, and after another paper is presented, then there will be opportunity for all of us to discuss them.

FRED R. FAIRCHILD (Connecticut): Ladies and Gentlemen of the Conference, Professor Hollander was not able to give me an advance copy of his paper, so that in discussing that paper I started on scratch with you all. In a rather long experience with programs of this sort I have learned that that is generally about the way it works out, and don't think that I am blaming my friend, Hollander. It happens that I have been on the other side of the fence often enough to develop a spirit of charity. At this very moment a distinguished gentleman is waiting for a promised address of my own to be delivered in New York in about two weeks, and if he gets it sooner than I got Professor Hollander's, he will be a lucky man.

I am in entire agreement with the masterly analysis of the economic theory of tax shifting which Professor Hollander presented, and I also welcomed his suggestion that the practical problem of administering the theoretical conclusion is a difficult and delicate one. I would be inclined to suggest it is so difficult that in the attempt to bring about a theoretical justification, more harm than good might possibly be done.

At only one point do I see opportunity to add anything to Professor Hollander's very comprehensive discussion of this matter. The justification of a tax such as this windfall tax rests first upon economic theory, of which I think there can be no valid question.

In the second place, it rests absolutely upon the matter of fact as to the shifting of the tax in question, and that matter of fact may not be so easily determined. That is what Professor Hollander referred to. The shifting of a tax like that may be partial, not complete, partly absorbed by the manufacturer. The shifting of such a tax takes time, and there is some question whether a tax of this sort in effect only one year will have been completely shifted in that first year. I would submit that in view of these difficulties, the burden of proof as to the fact of shifting should rest upon the government and not upon the taxpayer. After all, it was the government's illegal act that brought about the whole difficulty, and I think only if the government accepts this burden of proof may such a tax be justified in its actual operation.

As the chairman has suggested, Professor Simpson did put me a little bit on the spot by his all too generous comments upon my address of last year. I am quite frank to admit it is pleasant to take that sort of a commendation, and it is doubly gratifying at the hands of one whose sound, scholarly knowledge and common sense have always attracted my admiration and respect.

Professor Simpson was generally in agreement with me, and I find myself in the same way in agreement with him. There remains for me not much except to draw certain corollaries and add some extensions to matters which he has put before you.

I am glad, for instance, to find him in agreement with me as to the predominant place of the property tax in American state and local finance, and I note with very great interest his reference to the sales tax as about the only available source of large additional revenues open to the state and local governments. I don't know whether you recall, but I made precisely the same point with respect to federal finance a year ago, foreseeing that the next move to add a really substantial increase of revenue for the federal government would seem almost inevitably to direct us toward the sales taxation.

I was pleased to notice that Professor Simpson suggests that the sales tax deserves a little more charitable treatment than it generally gets, at least in popular discussion, and perhaps I am inclined to be even a bit more charitable than he was. I would be disposed to challenge the common assumption that the sales tax bears no relation to tax-paying ability. I think there is no tax of which that can be strictly said except the poll tax, which requires an equal contribution from each one.

After all, the wealthy man who buys much gasoline, pays more gasoline tax than his poorer friend. And so of all sales taxation. The amount of the tax bears some relation to tax-paying ability. It does not bear the perfect relation. It does not permit of the progressive relation such as the income tax allows. It does not, perhaps, even place a burden in proportion to the total income or

tax-paying ability of the taxpayer, but conceding all of that, we must not make the rather crude error of saying that the sales tax has no relation whatever to ability, when it is well known that some people pay five, ten, twenty, or a hundred times as much under a given sales tax than do others.

The sales tax, then, I say, does have some relation to ability, and it is a tax which in combination with other taxes, some of them progressive, may permit the building up of a general tax system providing whatever relation to tax-paying ability may be desired.

I am also disposed to refer to those of whom Professor Simpson reminds us, who regard the sales tax as an outlandish importation from European and Oriental countries. Let us not forget that broadly defined as taxation of consumption, such taxes have a long and fairly respectable record in the United States. For the first century and a quarter of our national existence, consumption taxes furnished virtually the entire revenue of the national government, customs tariff duties alone up to the Civil War; and tariff and excise were sharing the burden equally from then until 1913. Even the last few years the sales tax has come to the aid of federal finance to fill the breach caused by the collapse of the income tax.

Professor Simpson has lost hope of any reduction of the sales tax, and I share his disillusion on that point. He finds the reason for this in the enormously swollen expenditures of the federal government of the last few years, and I suppose he would add, of the years immediately in the future, probably.

I am inclined to think that blame for that situation also rests, and will perhaps rest even more upon swollen expenditures of our state and local governments. Already those have increased, in large measure due, I think, to the repercussions of federal action tending toward extravagant and reckless expenditures by state and local officials; also in the future, inevitably, I should say, just so far as the federal government passes over to the states the burden of provision for relief.

I also have lost hope, as has Professor Simpson, for any shift of the burden from the property tax to other forms of taxation. We all entertained those happy hopes at one time, and they are now, I must sadly admit, relegated to a distant and unpredictable future.

I welcome what Professor Simpson has said about the consequences of federal aid. He sees a weakening of financial responsibility and accountability of state officers. I see also tendencies in the direction of abdication of their functions by the state through the easy process of letting the federal government bear the financial burden. I fear also loss of the states' control of their traditional functions, loss of financial integrity, and with that comes inevitably, I fear, loss of actual sovereignty.

You were all interested, I am sure, by Professor Simpson's reference to Bolshevism, Nazism and Fascism. I was first of all pleased

to find him coupling these three nauseous terms in one sentence and apparently one category. There has been altogether too much popular notion that if you are not a Communist you must be a Fascist; if you are not a Fascist you must be a Communist, on the old theory that he who is not with us is against us. I resent being branded as a Fascist because I don't accept communism, and I equally don't want to be classed as a Communist when I abhor fascism.

As a matter of fact, study of the theoretical character of these three programs, as well as their practical exemplification in the three European nations which at once come to your minds, would, I think, indicate not very much choice between them. It is a Hobson's choice, after all. Each one represents a dictatorship, in the hands of a small party, with complete or virtually complete denial to the great mass of the people of those traditional American institutions such as personal freedom, and so far as the status of the ordinary inhabitant goes, I doubt if he would have much of any way of telling whether the party above him is a dictatorship of the proletariat or of some other self-chosen group.

I see just as does Professor Simpson the trend of these various movements which he has described in the direction of fascism, or whatever you wish to call it, and I also confess to his faith—even a blind faith, perhaps you may call it—in a certain inherited fundamental judgment and common sense on the part of the American people, which led me to think in spite of all the signs of the times that we are not destined to this unhappy end. That is comforting, but I, like him, would submit that however comforting that anchor to windward may be, it offers no reason for lack of watchfulness and opposition to tendencies pointing in this unhappy direction.

The fact is that there has always been in this country conflict between two principles of government, the all-powerful central government, and the federal form involving sovereignty of a company of separate states. The conflict arose at the very beginning, and Washington and Hamilton on the one side fought valiantly the cause of a strong central government, because at that time every danger came from the likelihood that these thirteen states would degenerate into little squabbling independent states, and every opportunity to develop a strong nation would be lost.

They won their fight for the establishment of a strong nation, and after only about a dozen years, the other party of Jefferson and Gallatin came into power and curbed the centralizing tendencies of the Federalists, caused the pendulum to swing the other way toward a depression of the powers of the national government and assume restoration of state prestige, and so the pendulum has swung back and forth in all our history.

That is inevitable and I think entirely proper. At the present time I think it has swung a long way toward the tendency of the

national government — so far, indeed, that I myself see a threat to state sovereignty. It is well enough to discuss these matters on terms of general principles, a question which I think we must always be facing, but let us beware lest while we indulge in academic discussion of principles, the cause be lost not by a frontal attack upon the real issue but by a flank attack upon the citadel of state and local finance, whereby the financial integrity and finally the actual sovereign existence of our states may be tost.

CHAIRMAN CUSHING: This conference is a democracy. If this were a fascist government I wouldn't call Professor Simpson or Professor Fairchild to order, but under the rules of procedure the papers shall be twenty minutes in length and then stop, and those who discuss them shall cease after seven minutes. I can't change that law, and I don't want to change that law. But the process of permitting these gentlemen to continue is one that is legal and proper, and I rejoice that you took the initiative and extended their time. It would have been a shame to miss any remark from either of them.

HARLEY L. LUTZ (New Jersey): Do you think if we had two presiding officers we might get a different construction of the rule?

CHAIRMAN CUSHING: I will be enough fascist to say that one is enough now.

The next subject before us is, "The Effect of the Depression on the Finances of Delaware." We will come down to our neighbor state. I don't think that Professor Daugherty is announced properly. It says here, "M. M. Daugherty, Agricultural Economist, University of Delaware." What is an agricultural economist? I claim to be an agricultural economist, because I have a farm and I make it pay. Any farmer who makes his farm pay these recent years is entitled to be called an economist, an agricultural economist. But I learned that this agricultural economist is a full-fledged professor of the University of Delaware.

GEORGE G. TUNELL (Illinois): I wonder if I may ask a question? Did you make a success of farming with or without federal aid?

CHAIRMAN CUSHING: The chairman is on the spot.

MR. LUTZ: Then, Mr. Chairman, I rise to suggest that you are an economic agriculturalist rather than an agricultural economist.

CHAIRMAN CUSHING: I accept the amendment.

Now we will hear from Professor Daugherty, who can tell us about affairs in Delaware.

M. M. DAUGHERTY (Delaware): Ladies and Gentlemen of the Conference, if the definition of an agricultural economist is one who

makes a farm pay, then I am certainly listed here wrong. Instead of being supported by the farm, I support a farm or so.

THE EFFECT OF THE DEPRESSION ON THE FINANCES OF DELAWARE

M. M. DAUGHERTY

Agricultural Economist,
University of Delaware

There is probably no one in this audience who has not had the effect of the depression on his state's finances brought to his attention. It has affected them all by decreasing their incomes and increasing their expenses. But I think I am safe in saying that it has affected the income of Delaware more than it has any other state. Some of the chief sources of Delaware's income are directly and immediately dependent upon the course of business conditions, and are very sensitive to changes in business.

TABLE 1

ORDINARY RECEIPTS, STATE OF DELAWARE, 1926-1936

	1926	1927	1928	1929
Income tax	\$905,183	\$1,326,310	\$1,589,264	\$2,171,325
Initial fees	1,296,440	836,065	898,947	2,693,453
Franchise taxes	1,222,864	1,062,593	1,221,307	2,307,441
Estate and inheritance taxes	140,785	190,575	621,707	2,576,275
All other	3,502,463	3,766,659	3,882,765	4,407,799
Total	\$7,067,735	\$7,182,202	\$8,213,990	\$14,156,293
	1930	1931	1932	1933
Income tax	\$2,884,437	\$1,939,691	\$577,016	\$653,830
Initial fees	2,438,807	806,041	480,354	204,375
Franchise taxes	2,555,483	5,177,095	4,301,587	4,173,755
Estate and inheritance taxes	1,852,975	1,770,924	2,067,201	2,289,681
All other	4,276,310	3,901,420	4,179,282	3,886,591
Total	\$14,008,012	\$13,595,171	\$11,605,440	\$11,208,232
	1934	1935	1936	
Income taxes	\$698,505	\$768,156	\$907,861	
Initial fees	137,910	129,588	165,854	
Franchise taxes	3,553,466	2,722,168	3,178,374	
Estate and inheritance taxes	122,280	447,920	459,474	
All other	3,929,525	4,334,810	5,283,329	
Total	\$8,441,686	\$8,402,642	\$9,994,892	

In order to present a perspective and give a basis for estimating the effect of the depression on the state's finances, I am presenting a summary of the receipts of the state from 1926 to 1935. The receipts are divided into two classes: those markedly affected by the depression, and all others. The effects of the depression upon the expenditures are so diverse and so indirect that time and space will not permit me to go into that phase of the matter.

The receipts which were most markedly affected are the income tax, initial fees for corporations, capital stock or franchise taxes, and inheritance taxes.

Income Taxes:

There has been a state income tax in Delaware since 1917, but only since 1926 can it be directly compared with the present tax. The effect of the depression on this source of revenue was very marked, but no more marked than the effect of the boom of 1929. The boom and depression affected all phases of this tax, as will be seen from an examination of Table 2.

TABLE 2

NUMBER OF TAXABLE INCOMES, TOTAL NET TAXABLE INCOME, AND
AVERAGE TAXABLE INCOME, 1926-1935

	No. of taxable incomes	Total net taxable income *	Average taxable income
1926	14,128	\$60,439	\$4,278
1927	14,686	68,655	4,675
1928	16,517	88,081	5,333
1929	17,147	118,728	6,924
1930	17,406	55,305	3,177
1931	15,119	50,946	3,370
1932	14,183	31,553	2,225
1933	10,213	28,310	2,772
1934	11,686	44,644	3,820
1935	13,247	38,149	2,900

Taking the average of 1926 and 1927 as normal, the boom year of 1929 increased the number of taxables 19%, the total net taxable income 84%, and average taxable income 55%. The depression year of 1933 reduced the number of taxpayers from the normal 29%, the total net taxable income 56%, and the average taxable income 38%. The changes in the incomes have been throughout the income tax structure, but they have been most marked in the capital gains. The changes in capital gains have been most marked in the 3% bracket or those having a net taxable income of \$10,000 or more.

* In \$1,000 units.

Table 3 shows the net taxable gains for all incomes, those for the 3% bracket, and the approximate tax paid by the 3% bracket on these capital gains.

TABLE 3

TOTAL NET CAPITAL GAINS, NET CAPITAL GAINS 3% BRACKET, AND
APPROXIMATE TAX PAID ON CAPITAL GAINS IN 3% BRACKET

(in \$1,000 units)

	Net capital gains	Net capital gains 3% bracket	Approximate tax paid by 3% bracket	Total tax due
1926	\$ 8,976	\$ 7,861	\$ 236	\$1,445
1927	17,840	16,371	491	1,639
1928	25,071	22,682	680	2,288
1929	51,956	50,304	1,509	3,141
1930	3,631	2,976	89	1,243
1931	1,321	1,062	32	1,180
1932	986	838	25	703
1933	1,382	1,077	32	610
1934	3,748	3,395	102	813
1935	5,660	4,967	149	863

Of course it is to be understood that these calculations are only approximate because they are arrived at by subtracting all the capital losses in a given year from all the capital gains for that year, whereas they are only subtractable within the same return. But the figures showing the tax paid by the 3% bracket are sufficiently accurate to say that it is the most changeable part of the income tax system, and that this changeableness is one of major proportions, varying acutely with the business cycle.

Death Dues:

The principal effect of the depression on the estate and inheritance taxes has been in the reduction of the value of estates of decedents. The large estates are composed predominantly of corporate stocks, and their taxable values are governed by the movements of the stock market. The drastic drop in stock prices has seriously reduced the revenue from this source.

Organization Fees:

Another important source of state revenue is corporation organization fees. This revenue is very variable too, as shown by Table 4:

An examination of Table 4 shows the very variable size of this revenue. Before the depression this revenue varied with the stock market. Since the depression it has not recovered its former co-variation, and many think that it will never recover.

TABLE 4
CORPORATION ORGANIZATION FEES, 1926-1936
(Calendar years)

1926	\$1,296,440
1927	836,065
1928	898,947
1929	2,693,453
1930	2,438,807
1931	806,041
1932	480,354
1933	204,375
1934	137,910
1935	129,588
1936	165,854

There are two reasons for this variation. One reason is the decrease in number of corporations, and the second is the decline in size of corporations. Table 5 shows the number and average fee paid by years from 1926 to 1935.

TABLE 5
NUMBER OF CORPORATIONS AND AVERAGE FEE PAID, 1926-1935
(Calendar years)

	No. corporations chartered	Average fee paid
1926	4,778	\$156
1927	5,424	107
1928	6,250	154
1929	7,537	266
1930	5,611	130
1931	4,235	81
1932	3,564	49
1933	3,094	39
1934	2,476	29
1935	2,398	33

Franchise Taxes:

The third important source of state revenue affected adversely by the depression is the "Franchise Tax" or capital stock tax levied upon corporations for the privilege of exercising their charters. Table 6 shows the number of corporations assessed for franchise taxes, the amount assessed, the number of corporations paying the tax, and the amount paid.

TABLE 6

NUMBER OF CORPORATIONS ASSESSED, AMOUNTS ASSESSED, NUMBER
OF CORPORATIONS PAYING, AND AMOUNT PAID, 1926-1935

	No. corp. assessed	Amount assessed	Average amount assessed	No. corp. paying	Amount paid	Average amount paid
1926....	26,117	\$1,485,958	\$ 56.89	19,657	\$ 994,974	\$ 50.66
1927....	26,928	1,679,579	62.37	21,415	1,252,532	58.48
1928....	28,801	2,234,308	77.57	23,629	1,795,109	75.97
1929....	31,246	2,793,206	89.39	27,447	2,262,685	82.43
1930....	34,908	4,894,747	140.21	28,937	3,812,982	131.76
1931....	36,097	6,155,804	170.53	29,017	4,536,782	156.34
1932....	35,008	5,665,608	161.83	26,735	4,136,859	154.73
1933....	33,510	5,248,826	156.63	24,535	3,749,170	152.80
1934....	31,107	3,413,162	111.33	20,857	3,245,905	155.62
1935....	28,716	3,183,188	110.85	19,755	2,951,198	127.56

The revenue from these corporations fell both from the fact that the number of corporations holding charters decreased and also on account of the decrease in capitalization of the corporations. This decrease in the capitalization of corporations occurred both in corporations which had long held charters and new corporations. The net decrease in number of corporations may be attributed to the direct effects of the depression, but the recapitalization downward is an indirect effect.

INDIRECT EFFECT OF THE DEPRESSION

The preceding discussion has shown the most important direct effect of the depression on the revenue system of Delaware, but the indirect effects bid fair to be more important than the direct. By indirect effect is meant the effects that are produced on the Delaware tax system by the actions of other taxing jurisdictions brought about by a scramble for revenue during the depression.

Mention has already been made of the recapitalization downward of Delaware corporations. From 1931 to 1935, 638 large Delaware corporations recapitalized downward, causing a total loss of \$1,080,045 in annual revenue. There were several incentives for this downward revision of recapitalization, but one of the most prominent of the incentives was to escape the stock transfer taxes levied by the federal government. These taxes levied by the federal government in 1932 amounted to 4c. per \$100 of face value, (or no par) unless the selling price were \$20 or more when rate became 5c. per \$100 of face value (and no par). The selling price governed the rate on \$100 worth of par value stock under the federal tax regulations.

A simple example illustrates the advantages of a low par share for transfer taxes:

100 shares, par \$1 selling for:	
less than \$20	Tax 4c.
more than \$20	Tax 5c.
1 share, par \$100 or no par, selling for:	
less than \$20	Tax 4c.
more than \$20	Tax 5c.

In other words, 100 shares could be transferred for the same price as 1 share.

This tax fell very heavily on Delaware corporations listed on the stock exchanges, for they fell very heavily on the no par shares, the backbone of Delaware capital stock taxes.

The effect of these laws was to make it financially very profitable for the large corporations listed on the stock exchanges to recapitalize downward. One group of 52 companies by changing to low par shares saved a federal tax of \$1,312,825 in 1935, and incidentally saved \$271,305 in state franchise taxes. This Delaware franchise tax is now in proportion to the assets of the corporation, if its shares are of low par value.

Another indirect effect of the depression is the increase in the federal income tax drying up the source of state income taxes. The following figures show the changes in deductions for taxes paid in the Delaware income tax from 1929 to 1935. The percentages in Table 7 are percentages of net taxable income before tax deductions. The four columns show the proportion of net taxable income that is paid by all taxpayers, those taxpayers in the 3% bracket, the percentage paid by the taxpayers in the 3% bracket who have incomes of \$50,000 or more, and those who have \$250,000 or more.

TABLE 7

PERCENTAGE OF NET INCOME BEFORE TAXES ALLOWED AS A
DEDUCTION FOR TAXES, 1929-1935

	All income taxpayers	Income taxpayers having annual incomes of:		
		\$10,000 and up	\$50,000 and up	\$250,000 and up
	%	%	%	%
1929	9.00	8.14	8.40	7.33
1930	14.22	16.75	20.85	23.54
1931	9.47	10.21	11.83	11.61
1932	10.58	11.30	14.14	13.21
1933	17.44	21.22	29.10	34.20
1934	10.02	8.14	7.97	10.18
1935	19.50	26.86	35.19	38.50

The taxes deducted are "all taxes, except Delaware income tax," and consist chiefly of general property, motor and federal income taxes. Since the major portion of these taxes are paid by persons in the higher income brackets, this increase in taxes decreases the income tax yield at the correspondingly high rate of 3 per cent. By the nature of the case the tax can only be the leavings of the federal income tax.

Delaware is fortunate in having a large number of wealthy and generous citizens, who make large gifts to public enterprises. An additional effect of this high federal taxation is that it prevents these citizens from giving on anything like the same scale they previously gave. Not only do the high tax rates affect the giving by leaving a less net income, but the various interpretations also affect the disposition to give.

It is impossible to give a clear and unequivocal proof from income tax statistics that as federal taxes have increased donations have decreased, because the income statistics are not presented so that a norm can be ascertained. These gifts are now about one-third what they were in 1929, the year in which contributions first became an allowable deduction.

CHAIRMAN CUSHING: From the taxpayers' standpoint, out in the west, we hear of Delaware as the great refuge for taxpayers. A trust officer, even, of one of the trust companies in Wilmington—I won't mention any names—is in Chicago hoping to have a large trust estate moved down to that trust company in Wilmington, Delaware, and almost the only reason was that he could show how much would be saved in taxes to the poor taxpayer who is troubled with all of his millions out there and is afraid they are going to be confiscated by the personal property tax that is now being imposed upon intangibles in Cook county. But I am not going to preempt the discussion of any of these papers.

The time has come now for open discussion. I will be glad to hear from anyone who wishes to be heard.

HARLEY L. LUTZ: I was particularly interested to have both Professor Fairchild and Professor Simpson begin to take down their back hair, so to speak, with respect to the subject of ability. I have been coming more and more myself to the conclusion that it is about time that someone who was thoroughly competent should reexamine the concept of ability, first, because of some possible question regarding its necessary theoretical function, and secondly, because of the extent to which ability has been overworked. It has been so sadly misused in so many connections that I think it is time we had a clearer and fresher statement of it.

I think in that connection there is a tendency to over-emphasize Adam Smith's first canon, and to neglect somewhat the bearing of

the other canons of taxation suggested by Adam Smith upon the first one, not with any hope that we can ever get a perfect tax that will ideally carry out the full implications of the four principles together, but with a view to discovering if possible the extent to which the original or the first one might be modified in certain respects by taking into account some of the others.

Let me illustrate. As both speakers—in fact, as all of the speakers who dealt with this subject—pointed out, ability has a certain standardized meaning and we immediately pass judgment on any tax by saying that it doesn't conform to ability, meaning, if the small income fellow pays a certain amount of tax and the man with a large income pays the same amount of tax, it is regressive with respect to the smaller income—it is a larger percentage of the small income than it is of the large income.

We assume that that is all there is in the question of ability to pay, and so we have fallen into the habit of condemning certain taxes, conspicuously the sales tax, because we say right off-hand it violates this fundamental principle of ability to pay, it is regressive.

But that isn't all there is to it. Adam Smith said in another one of his famous maxims on taxation, "the tax shall be collected in the manner and at the time most convenient for the taxpayer to pay it." In a practical sense, not in an abstract theoretical and, I might say, mathematical sense, but in a practical sense, I think that has a good deal to be said for it.

For example, we have recognized the installment principle of payment to some extent in the income tax. The federal law permits four installments. A few of the states permit four installments—some of them two installments. Some others require it all to be paid in one installment. In a few states the property tax may now be paid in installments, as many as four.

In New Jersey, for example, the sales tax and all indirect taxes carry that principle of convenience of payment to the nth degree. You are never required to plank down any large amount in cash on account of the gasoline that you buy. You can pay it in dribblets. None of the sales tax states require you to fork over a large sum on the first of the month on account of the groceries or the coal or any other commodities that you have bought subject to the sales tax during the month. They apply perfectly the canon of convenience. They are collected at the time and in the manner most convenient for the taxpayer to pay them. Furthermore, I should like to point out that they conform admirably to the other principle that Adam Smith suggested, namely, that the amount of the tax should be certain and not arbitrary.

I don't know that we have ever had a case, so far as the ultimate bearer of gasoline or sales taxes is concerned, in which the tax department has sent the tax bearer a notice two years afterward to the effect that "our auditors have discovered that you did not pay the

correct amount of gasoline tax or sales tax for the year 1935, and we are therefore proposing to assess a deficiency tax against you on account of gasoline used in your Ford in the year 1935. That tax is so much and we demand payment within a certain time."

Of course you can show cause — with interest and penalties and some other very unpleasant alternatives if you don't come across. No one has ever any doubt about the amount of his gasoline tax, or if he has, all he needs to do is to be able to read figures and he can look up at the pump and see what it is.

Few people are ever in any doubt as to the amount of sales tax they are paying. There is never any question of going back over the amount of groceries in the year before last bill and assessing a deficiency tax against them. So far as the certainty of the tax and the convenience of the tax are both concerned, I suggest that many of the indirect taxes stand up very well.

So if we ever get around to that state of mind in which we are willing to think of this question of ability to pay as involving not simply a kind of "bastard" mathematics, because that is what it is in reality, a kind of "bastard" mathematics by which we have concluded that certain taxes are regressive and therefore undesirable, and look at the thing from a more realistic, a more practical, a more common-sense point of view, we may find that we have been on the wrong track in considerable degree in the past with respect to our construction and application of the ability principle.

That doesn't mean that we will immediately proceed to scrap the income tax, or the death duty which is levied at progressive rates on one's total possessions on a certain occasion. It does mean, however, that we would be forced to liberalize our judgments with respect to the quality of some of these other taxes, and while you wouldn't need this exhibit, the figures that Professor Daugherty has just given you from the state of Delaware will show you how exceedingly flimsy a reed you have in the kind of income tax that we use, because it is essentially a prosperity tax. It isn't worth a "hoot" in a depression, and if it hadn't been for the indirect taxes that the federal government used and the indirect taxes the state governments used, I hesitate to try to picture to you the kind of financial chaos in which the federal or state governments would be likely to be.

So while it may not be within the province of the association to undertake a theoretical inquiry of this sort, I suggest that somewhere, perhaps among the academic fraternity, there is a challenge to attempt a restatement and a revaluation of all of the elements that need to be considered when we are talking about ability to pay.

A. D. SCHULTZ (Ohio): I would like to say that it is, indeed, gratifying to hear the economists suggest that they ought to come up to date on this question of ability to pay. The reason for the

graduated rates in the income tax never has been genuinely, from the standpoint of practical taxation, the adjustment according to ability to pay. The notion that it was is simply the result of a series of preachments in books on taxation. I taught in Ohio Wesleyan University for four years and I never preached that the income tax should be at a graduated rate on account of ability to pay. You simply levy more taxes and collect more taxes by graduated payment. The sales tax is simply another form of the proportional percentage taken according to income for spending capacity—the same old story of ability to pay, it seems to me.

I state again, I am glad to know the economists are bringing themselves up to date.

CHAIRMAN CUSHING: I understand there are people here in attendance representing the government at Washington—some departments of it. We will be very pleased to hear from any of them.

It seems as if at previous conferences we have had more representation from the federal government than we have at this one.

Is there a Mr. Savoy in the audience? We would be pleased to hear from him, I am sure.

PREW SAVOY (District of Columbia): Ladies and Gentlemen, I do not represent the government at Washington. I am a practicing attorney there. But when the windfall tax was devised and passed, I had charge of the processing taxes for the AAA and took an important part in the drafting of the windfall tax. I was very pleased to hear it defended today.

I have some questions to ask, however, of the economists concerning the act which I have never been able to understand.

MR. LUTZ: You wrote it.

MR. SAVOY: The act was written by economists and lawyers. Up to that time the economists had tried to think as lawyers and the lawyers had tried to think as economists. When we came to two parts here with respect to which I would like to ask two questions of the economists, the economists thought as economists and the lawyers couldn't understand them.

One has to do with ability. The original concept was that the taxes had either been passed on or had been taken out of the price paid to the producer. Therefore, there was a real ability to pay, due to the fortuitous situation arising from the invalidation of the act, when those taxes had not been paid. But in Section 501 (L), it is provided that the tax is imposed on the net income arising from the sources specified, regardless of any loss arising from the other transactions of the taxpayer, and regardless of whether the taxpayer had a taxable income for the taxable year.

In other words, if a taxpayer had a fortuitous income of \$50,000, but a net loss of \$50,000 for the year's operation, he paid the tax

of 80 per cent on the \$50,000. Now I ask, what has become of the ability to pay in that situation? I think only an economist can answer that. I am sure I can't as a lawyer.

The second question I have relates to the matter of proving the burden of the tax, proving where that burden was, or at least that it was sustained or not sustained in this particular case by the persons subjected to the windfall tax. In Section 501 (I), it is provided that if the taxpayer asserts that the burden of the tax was borne by him while the burden of any other increased costs was shifted to others, the commissioner of internal revenue shall determine from the respective effective dates of the tax, and the other increase in costs, as compared with the date of the change in margin, and from the general experience of the industry, whether the tax or the increase in other costs was shifted to others.

I have discussed this with various businessmen to find out which costs they pass on first. Let us suppose that you have costs of \$50,000 for your raw materials and all costs other than the tax, and a tax of \$50,000, making a total cost of \$100,000, and you sell your articles for \$60,000. Which cost have you passed on? Would the economists say, "Well, you passed on first your cost of raw materials because that is the first thing you had? But you didn't pass on any of the tax. That extra \$10,000 was part of your overhead, because that came before you had to pay the government your tax." Or would you say, as some taxpayers say, "Well, I might not have had to pay for my raw materials, and I might have delayed payment of wages. I couldn't delay paying the tax without going to jail."

I would like to know from a practical standpoint, and I realize that Professor Hollander and Professor Fairchild have admitted that there are some very serious practical problems in the administration of this act, but I would like to get clear in my mind the theory that exists in the minds of economists as to how you determine which of a number of costs you pass on first.

CHAIRMAN CUSHING: Mr. Fairchild?

MR. FAIRCHILD: I would only say I didn't admit there were practical difficulties, I asserted that there were.

R. K. SEIDMAN (Tennessee): I find that I am in a rather embarrassing situation with all the developments going on here. Nobody has yet indicted the CPA, so I am safe on that ground. As an attorney I have been just thrown out, and as an amateur economist I suppose I will be safe by admitting that I am an amateur and only entrusted with the job of teaching bankers some economics—and they are not supposed to know anything.

But I am just wondering whether there isn't a difference between the ability to pay and the ability to exist. Despite my tender years,

I may be old-fashioned enough to believe that maybe Engel had something when he stated his law. Then mention has also been made of the fact that the convenience of collection of the tax makes it a proper tax. I state that that is exactly what is wrong with some of our sales taxes, the fact that the amount of tax burden is due to the fact that the public at large does not recognize what their tax load is. We must educate them as to what the extent of their tax load is, and to that extent I might agree to a sales tax as an ultimate test to bring home to the consumer what he is paying in indirect taxes.

On the other hand, I wonder whether very many in the audience, with the exception of our friend, the government representative, really favor the processing tax, which was nothing more than a sugar-coated sales tax.

As I say, I am not entrusted with very much of a job, but I would like to get the answer. If I am a traitor to the cause of teaching economics, I would like to be straightened out right now, Professor.

HARLEY L. LUTZ: May I answer the last gentleman, if I may speak again?

The question that the gentleman raised was with respect to the value, the effectiveness, usefulness, of the sales tax in preference to some other type of taxation, and I am rising again simply because I should have added there to my brief remarks. I stressed certainty and convenience because I think they are attributes of certain forms of taxation which we care altogether too little about. The man who has to pay a certain amount of sales tax or gasoline tax as he buys his articles of consumption would yell like a stuck pig if you didn't collect it that way but hauled him up at the end of the year and said, "You owe so much gasoline tax for the gasoline you used during the year." I submit there isn't a person in this room who wouldn't prefer to pay a larger amount either in sales tax or as gasoline tax, in the manner it is now paid, than to wait until the end of the year and then have the kind of procedure through which, let us say for example, the income tax goes in order to determine the amount and pay it all in one lump sum.

I think we overestimate the ignorance and indifference of consumers when we imply that they do not know what it is all about. I am inclined to say that we ought to, on the other hand, give them credit for enough intelligence to appreciate the merit of that method of collection and to be willing to pay a somewhat larger tax in that way than to have to submit to the inconvenience—in many cases it would be a serious inconvenience—of forking over a smaller total sum in one lump payment.

Adam Smith said, "There is a certain price which men are willing to pay in order to be free from the odious oppression of the

tax-gatherer." I believe that a great many people are willing to pay a somewhat higher price for their share of the cost of government and do it in a way that frees them from the inquisitorial methods and the odious oppression of the tax-gatherer to which they are inevitably subject when the tax is based upon net income and is collected in the manner that has become so popular for the administration of that task.

One further word—about tax-consciousness: an immense amount of bunk has been written and said about that subject, and I confess that I in earlier years have been guilty as a contributor. The argument is, of course, that when people become tax-conscious they immediately go down to the city hall or to the state capitol and demand clean, honest, efficient government. That is only a pious hope, very largely unsupported by experience. That is not what happens when people become tax-conscious, except by accident.

Any kind of a tax will produce a reaction, of course. But what direction will the force take? You can no more predict it than you can predict the direction of the explosive force of dynamite. In New Jersey we had a sales tax, and it made the people very tax-conscious. Did they go to Trenton? No, except to demand the repeal of the tax. That was the direction the explosive force took in New Jersey, and they got away with it. They did promptly compel the repeal of the tax. They didn't compel better or cheaper government. Not at all.

The eighteenth century Englishman was tax-conscious of the excise, and that was an indirect tax. Did he demand from each of the three Georges in turn that they give him better government? Not at all. He took it out in clubbing and knifing the excise tax collectors when he got them in a dark alley. He took it out in smuggling and in an extraordinary satisfaction from the consumption of smuggled liquor and tobacco because of the way in which he had put it over on the hated excise man.

If we want tax-consciousness—and I will agree that there is a proper place for that term—I think it is futile to count on getting it in any large degree through the ordinary operation of the tax system. The way to get it is to go out and organize yourselves in the form of taxpayers' associations or civic leagues or some other civic groups and then feed your members enough good hot stuff on what is going on in the city hall or state capitol or county government or some place else to get them really lined up behind the proposition that you want to put across. If there is economy in government, that is the way you are going to get it. You will never get it in the world if you sit around and wait for the possible chance that because of the impact of some tax they are going to rise in their might as citizens and clean up the situation you are dealing with.

CHAIRMAN CUSHING: Is there any further discussion? Does anyone want to testify further as to the efficiency of the sales tax and gross income tax?

J. W. OLIVER (New York): I would like to ask Professor Hollander if he will attempt to answer the question that Mr. Savoy asked about what costs are passed on first, and how you are going to determine that. That is quite a practical question right now, if you are to assume that most taxpayers who are attending this conference are actively engaged in determining the degree of windfall tax. I would like to know whether or not they have a right to recover under Title 7.

J. H. HOLLANDER: Mr. Chairman, surely an economist ought to be protected against so direct a question as to what should be the practical procedure. He is virtually clear of any such equipment. But I should say that the multitude of sins which your question exposes at least could be sort of covered by the term "administrative necessity." That is, after all, the warranty for arranging the question as to the practicability of the task, which is theoretically sound. It is easy enough to relegate to the limbo of administration the difficulties of the measure, and to say, "This is a sound tax," but it is a very, very considerable question as to whether a tax which is sound theoretically but which is attended by such insuperable difficulties in actual administration has a proper place in the tax field.

Now, Mr. Chairman, since I have the floor I feel that loyalty to my faith compels a caveat against the views so clearly set forth by Professor Fairchild and Professor Lutz. It seems to me, with reference to the doctrine of ability, a clear distinction must be drawn between what is the principle, what is the ideal to which a tax system should conform, and a rationalization of the tax practices which obtain.

I wonder whether the situation hasn't come to this: For a century and a half and longer — for there were profits before Adam Smith — the relation of the citizen to the state has been defined as "contribution according to his economic capacity." During that period what we have seen is a progressive departure in practice from that, partly through the administrative difficulties, partly through the greater ease, less legislative resistance, less popular hostility. We now face a situation where the economist may either continue crying like a voice in the wilderness or turn and say, "Well, after all, we have, and we are, drifting toward the sales tax and the indirect tax. Perhaps there is something more in it. Perhaps we have been worshipping false idols. Let us see whether after all this to which states have drifted isn't a safer procedure theoretically, a safer principle theoretically, than we had supposed."

I think, *seriatim*, the objections that have been raised could be answered. Of course, an indirect tax, an excise on gasoline, is perhaps more convenient than a quarterly encounter with the collector of the income tax. So it is very much more convenient for me if I buy a pair of shoes to pay twenty-five cents a week toward it. But it is bad economics, and if I have intelligence I pay the smaller price for a cash purchase than the easier and higher price of an installment purchase.

Contribution to the state in the form of successive installments is the familiar device of the sugar-coated pill, of the greater ease, and it is in violation of that which I cannot but regard as a fundamental principle of the relation of the citizen to the expenses of government, contribution according to his economic capacity.

One last think and then I am done. I likewise can give no assent to the doctrine that economic ability is evidenced by expenditure. Economic ability is indicated by potential expenditure, not by actual expenditure. If I have an income of a million dollars, that represents my economic capacity, but I can't go on collecting steam yachts indefinitely, and I may not spend more than \$25 or \$50 of it. If I pay according to what I spend, and not according to what is my income, I am not contributing, it seems to me, according to the principle of economic capacity.

CHAIRMAN CUSHING: If there is no further discussion I will entertain a motion to adjourn.

(A motion was duly made and seconded that the meeting adjourn.)

CHAIRMAN CUSHING: The meeting is adjourned.

SIXTH SESSION

TUESDAY, OCTOBER 26, 1937, 8 P. M.

PRESIDENT LESER: I am in the peculiar position of introducing to you a gentleman to preside at this meeting who will introduce me. However, I was introduced to him a good many years ago, and we have had a great many "run-ins". Up to date I am afraid the score is on his side.

Mr. Saxe is a very fine fellow, in spite of the fact that, like myself, he was once the chairman of a state tax commission. Also, like some of you, he was a member of the state senate. But over and above all that, I understand he was chairman of the taxation committee of the constitutional convention of New York—I think it was 1915.

His work was so well done on that occasion that he has been invited to participate in the coming constitutional convention of New York. He has been nominated, he tells me, but you know, gentlemen, there is many a slip.

So without further ado, because I am going to have something a little later on to say about the gentleman, I present Mr. Martin Saxe, of New York.

MARTIN SAXE, presiding.

CHAIRMAN SAXE: Fellow members of the Conference, Ladies and Gentlemen, Guests: I feel it is a high privilege, after many, many years of membership in the National Tax Association, to have been selected as a presiding officer at one of the annual conferences. I have looked forward to it for a long time, and I am so happy it has now come about.

Judge Leser spoke about the constitutional convention of 1915 in New York state and about the approaching constitutional convention which will meet next year; we are having our election for delegates on the second of November.

I am reminded of an incident in that convention. There was a great fight over what was popularly known as the short ballot, by which certain state officers were to be eliminated from the hands of the electorate and appointed by the governor. Because of that proposition there was a division in the convention between two groups, one known as the federal group, led by such men as Elihu Root, the president of the convention, General Wickersham, who had been attorney-general of the United States, and Colonel Stimson, who was subsequently secretary of war and secretary of state.

On the other hand there was the so-called old guard crowd, composed of the old Republican leaders in the state, and that crowd had among its leaders William Barnes, of Albany, Senator Brackett, of Saratoga, and Lemuel Quigg, former congressman from New York.

When it came to the debate, which was the great debate of the convention—it lasted some three days, on the subject of the short ballot—Mr. Root decided that he would address the convention from the floor. I was selected to preside over that session. Mr. Root said, "I have only one suggestion to make and that is when I decide that I want to speak I will send you a notice, and I expect to be recognized."

In order to make the evening interesting—it started in the evening but it lasted three days—I asked the delegates who wanted to speak to send their names to the rostrum. A great many wanted to be heard on that question, and they were lined up either with the federal crowd or the old guard. My idea was to sandwich the interesting speakers with the uninteresting ones so as to keep the convention in good humor, and I did the best I could, but there was one chap, a former member of the assembly—Charlie Betts was his name—a very well known figure up-state, who belonged to the old guard crowd and who was very anxious to be heard. He had prepared what to him was an important address and it was the moment of his life.

So he kept running to the rostrum to be recognized. Well, as he was not one of the most interesting speakers, I was waiting for the right opportunity. But he pestered me so that I finally said, "All right, Charlie, I will recognize you next." Just then Senator Root signaled me. Well, of course, I had to recognize Senator Root, and Betts came up to the rostrum and what he said is not fit for repetition. So I turned to him and I said, "Why Charlie, didn't they tell you?"

He said, "Tell me what? What do you mean?"

I said, "Didn't Barnes, Brackett and Quigg tell you that you were to answer Root?"

He went back perfectly satisfied, a happy man.

But I was punished for what I thought was my cleverness because when Senator Root finished his address nearly everybody went out and I had to sit there and listen to Charlie Betts.

I speak of that incident tonight because I have no such trepidation. We have an excellent program, and I shall enjoy sitting through it to the last, even until the discussion is completed.

My first function is to introduce a gentleman who, as you have frequently heard said, needs no introduction. But it is part of the formalities and I must say a word about him. It is now at least fourteen years since we started on opposite sides of an important question, that is, the taxation of national banks, and he and I have

fought and bled at Philippi many times. I think he bled more than I did. He indicated tonight that I was a little bit more of a survivor. But I want to say this about him, that no matter how bitterly we fought, I found him always to be a gentleman. He could take it on the chin and shake hands afterward and we could go on with our friendship as though nothing whatsoever had happened at all.

It was because of those many fights that we had at Washington over national bank taxation that I came to admire and respect Judge Leser, and I know that you all admire and respect him as I do.

I now take great pleasure in presenting Judge Leser to you.

ADDRESS OF OSCAR LESER, PRESIDENT NATIONAL TAX ASSOCIATION

Mr. Chairman, Ladies and Gentlemen of the conference: I have it on the authority of our worthy Ex-President, Henry F Long, that "the ideal president of the National Tax Association is a person who neither says anything or does anything or knows anything." He was probably thinking of the Japanese motto, "Say nothing, hear nothing, see nothing"; or of the old Methodist injunction—so hard to follow here in Maryland—"Touch not, taste not, handle not." However much I should like to be excused from saying anything, I find myself hampered by the tradition surrounding the office you have so graciously conferred on me and, worse still, by the action of the program committee which has inflicted on me the duty of addressing you, and on you the burden of listening.

My service as president of the association is coincident with my departure from the field of active tax administration, in which I had been engaged for over a third of a century. Those of you who were present at yesterday's opening ceremonies heard the story of how, after he had elevated me to the chairmanship of the Maryland State Tax Commission, the governor saw fit to transplant me to a different field of duty. But let me assure you that my interest in the science of taxation and especially in tax administration has not abated but will be sustained to the end; and to the limit of what may comport with the ethics of my new position I shall continue to be active in promoting what I conceive to be sound and equitable principles of taxation and efficiency and justice in its administration.

As one of the old guard who joined the National Tax Association in the first years of its existence—and it celebrates its thirtieth birthday this year—I am proud of its achievements. It has established itself as an educational institution of highest usefulness in its chosen field. It has provided an open forum for the discussion and consideration of all questions germane to its avowed purposes. The wisely conceived plan upon which it operates in sponsoring these

national conferences—composed not of its own members, but of disinterested delegates appointed by the governors of the states—and the strict adherence to this plan, has given to the carefully considered pronouncements of these conferences a degree of authority which could hardly have been dreamed of by the small band of enthusiasts who started it on its way.

In this connection, and because of the changing memberships of recurring conferences it will not be out of place to remind you of two significant provisions of the By-Laws of the association. Section 1 reads:

“The annual conference shall be the means used by the association for carrying into practical effect its purpose to secure an expression of opinion that will formulate and announce the best economic thought and ripest administrative experience available for the correct guidance of public opinion and legislative and administrative action on all questions pertaining to taxation and to interstate comity in taxation.”

And Section 4:

“No resolution approving or opposing legislation shall be considered by the conference unless it has been discussed at a session of the conference at which it is proposed, or has been the subject of a report made thereon by some committee of the conference or of the corporation, or has been the subject of a resolution adopted by some previous conference.”

Special attention to this last quoted condition should be given by the members of the committee on resolutions, because past experience proves that it is enforceable and will be enforced. When our conferences go on record as favoring or disapproving legislation they do so carefully and with full knowledge of what they are doing, and then only after thorough consideration. By another provision the action must be practically unanimous, namely by a four-fifths vote or better. These rigid safeguards explain why conference resolutions on public questions are few in number but potent in their influence.

It is interesting to recall that though the association was formed in 1907 to deal only with state and local taxation, it became necessary as long ago as 1913 to amend the constitution so as to embrace also problems of federal taxation because of the then growing tendency of congress to trench on the states' preserves. Indeed, it is rather remarkable that the first resolution passed at the very opening conference of 1907 suggests a prophetic fear of what the later years were to bring. It is worth quoting:

“WHEREAS, The several states are now taxing inheritances with marked success, and need all the revenue that can properly be drawn from this source; and

WHEREAS, The federal government can readily raise additional revenue, when required, from other sources;

RESOLVED, That it is the sense of this conference that inheritance taxes should be reserved wholly for the use of the several states."

Today we find that the colossal expenditures of the federal government have brought it, in the search for revenue sources, into conflict with the states at many other points. Attempts to secure agreement upon a fair basis of division of sources and upon methods to put it into operation, are engaging the attention not only of congress through its committees and of state authorities but of organizations like the Council of State Governments, the National Association of State Tax Administrators, the American Academy of Political Science and the 20th Century Fund. At the September Conference of Governors it was resolved to hold a special meeting to deal with this subject. The governor of Vermont had called attention to an act of congress, passed in August, which authorized the states of Vermont, Massachusetts, New Hampshire and Connecticut to enter into a "Connecticut Valley" compact, but with the reservation that all reservoir, power and storage sites be held by the federal government. He protested against this condition because the taking of such rights from the towns without recompense for loss of taxes and power rights would cause many of them to face bankruptcy. This is an illustration of the difficulty of reconciling conflicting claims in working out any comprehensive scheme of water power conservation and control.

In January 1932, while he was governor of New York, Franklin D. Roosevelt deplored the lack of coordination between the taxing systems of the federal government and the several states. "Business men," said he, "have neither the courage nor the intelligence to suggest that the whole taxing system in America be put on a business basis." You may be surprised to learn that the cure he then urged was to "follow the original principles established in the constitution in 1787." At that time, apparently, he had a good opinion of the "horse and buggy age."

It has been estimated that public expenditures in the United States, federal, state and local, exceeded 17 billion dollars, and that aggregate revenues fell 5 billions short of that; and that each of these divisions of government—considered as a whole—showed an unbalanced budget. The annual tax load averaged about \$100 for every man, woman and child in the country. Is it then a wonder that taxation and public expenditure has become the paramount problem of the day? Taxes are now at their peak. They are affecting the poor as well as the rich.

It is in sharp contrast to conditions in 1837—just a century ago—when the federal government had an embarrassment of riches and

actually declared a dividend in the form of a distribution of its surplus among the states. In those days people regarded taxation as a necessary means of meeting the costs of government. The idea that it should be used for other purposes such as to effectuate social reforms or to cut up "swollen fortunes" or to redistribute the wealth of the country, had not occurred to anyone. Many still hold to that theory of taxation. Even a half-century ago we had a president who believed that the people should support the government and not that the government should support the people. If we don't watch our step the share-the-wealth doctrine which arose in more recent times may eventually result in a share-the-poverty condition.

Years ago, when Reed Smoot of Utah was chairman of the senate finance committee, he gave utterance to a sentiment which, in my state, has come to be known as Smoot's Law. It is this: "The cost of government will continue to increase, I care not what party is in power."

Up to the present year this law has stood the test of time. It may come to rank with the theory of Malthus, or even to outrank it since there is a disposition nowadays to debunk Mr. Malthus' pronouncement.

However, we must face the fact that high taxation is here, and here to stay for a long time, though some relief may be brought about by economy—an end to which we should of course give our hearty support. The practicable task before us is to improve the systems under which the needed revenue is to be raised. As we must have high taxation let us strive to make it fair and equitable, not only as between the different levels of government but also as between individuals and property interests and localities. We should ever remember that resentment against unfair taxation—not necessarily against high taxation—was one of the prime causes that led to the establishment of this nation.

It is not my purpose to enter into a discussion of various phases of taxation, but rather to touch briefly upon one important subject which deserves ventilation and to which I have given much attention during my service on the state tax commission.

The presence of my good friend Saxe stimulates thoughts on the status of bank taxation throughout the country. He and I have been so frequently in conflict on this question—at congressional committee hearings, at tax conferences and elsewhere—that I am as certain that he thinks of the bank tax whenever he sees me as I am that I think of it whenever I meet him. In me it arouses a feeling of regret and disappointment that congress could have been induced for so many years to allow a bad situation to "stay put"; while to him, I imagine, there comes a feeling of great satisfaction over the sizable rewards which have been his for his services in maintaining the status quo.

In 1921 there was a decision by the supreme court in a case known as the Richmond bank case, based on an erroneous assumption of fact due to an inadequate presentation of vital evidence. There was some excuse for counsel representing the city of Richmond because the issue on which the court of last resort made its ruling was not the real issue as the case was presented before the Virginia courts. Had the case been sent back for further testimony on the matters deemed important by the supreme court, I am confident that the final outcome would have been different. However, the effect of the decision as made was to render illegal the laws of nearly all the states under which laws national banks had been subjected to an *ad valorem* tax on their shares, and to which laws the banks had conformed and adapted themselves without complaint for many years. The phrase "other moneyed capital," as used in the federal act permitting the states to tax the shares had been construed in the course of a succession of rulings by the highest court as meaning that the states could lawfully tax such shares provided the tax burden was not heavier than that imposed on competing capital, namely on the shares of state banks and trust companies. In other words, the treatment of banks and trust companies as a class was recognized as fair and lawful. For thirty-five years this construction had been uniformly observed and many states, relying upon it, had introduced classified taxes or income or excise taxes on other forms of intangible property. The startling effect of this Richmond bank case decision was to bring into the comparison all sorts of intangible property—bonds, notes, mortgages, shares of business corporations, etc.—which had in the meantime been given different treatment because by common consent they were deemed not to be in competition with the shares of banks. And of course, the fact is, that such forms of property are not competitive, unless it be assumed that every investment, real or personal, by diminishing the amount of capital available for investment in bank shares, thus becomes competitive. This astonishing theory of competition was in fact the basis for the conclusion reached by one of the officers of the bank in the Richmond bank case, whose testimony furnished the foundation for the ultimate decision.

There has followed a long-continued effort to cure the unfortunate situation thus created. States like New York and Massachusetts, which had prior thereto adopted the income tax for other forms of intangible property were compelled to refund many millions of taxes which the banks had paid without complaint under a law fostered by them many years before. As the taxes which they had paid and then got back had already been shifted to their customers, the refund came in the nature of a windfall. Mr. Saxe well knew this, but he can't be blamed for making the best of his opportunity.

Congress passed two amendments to the taxing provision, one of which gave to the states the alternative right to impose an income tax or an excise tax based on income, but so hedged about with conditions that the tax collectible in this way is but a small fraction of what would be received from a property tax on shares had there been no Richmond case. Massachusetts, for instance, gets less than one-fifth under the excise tax; New York, about one-fourth; in other states it is as low as one-eighth. Oklahoma's receipts from banks (other than from real estate) shrunk for one year from a million dollars to about fifteen thousand. In the course of time perhaps a dozen states have been compelled to resort to the reduced method. Other states, bound by constitutional restrictions, have been driven to the humiliating expedient of taking what the banks choose to give them. This is euphemistically styled "taxation by gentlemen's agreement." I understand that over half of the share-tax states are thus circumstanced.

The depression years have made it impossible to get the attention of congress on this serious and inglorious situation. In 1934 a carefully drawn measure—the Steagall Bill—received the approval of the house banking and currency committee, supported by an elaborate report whose conclusions have not been combatted. Under this bill the states are given the right to tax national banks either on their income or on their shares but may not subject them to a heavier burden than that imposed on state commercial banking corporations having capital stock. This gives them all the protection against unjust discriminatory taxation that they had during the thirty-five years of satisfactory operation antedating the Richmond Bank decision; and it does more for them than congress has done for the railroads and other interstate public utilities or for any other form of investment in a private enterprise. For these others the fourteenth amendment is a good enough guaranty of the equal protection of the laws; and it really ought to be all the banks should have.

The basis for the theory that the states can tax national banks only if and as congress permits, is that they are federal instrumentalities. This question of tax immunity of federal agencies is becoming of increasing importance because of the great number of alphabetical organization created in recent years. The supreme court is giving closer scrutiny to their claims and is getting inquisitive regarding the nature of such agency. At first they considered whether they were performing an essential governmental function or one customarily performed by the government. They are beginning to consider whether the function is not more commercial than governmental; and whether the governmental function is the main purpose or one which is only incidental to the actual purpose of private profit. In the recent Panama Railroad Company case, the court held that the performance of a commercial function—that is,

carrying freight and passengers for hire—did not subject that company or the salaries of its officers to state taxation, because this commercial business was wholly incidental to the main purpose for which the government owns and operates this company's property, namely to service and protect the Panama Canal.

It may well be that on closer consideration the court may be brought to realize that as the main purpose and function of national banks is that of conducting a private, commercial business, for private profit, with governmental functions merely incidental to the real, motivating purpose of their creation, the immunity and special favor heretofore accorded should not be continued.

If that should happen the banks would have nothing to fear, if we may judge by the 35-year record which I have mentioned, and remember that the fourteenth amendment is still in the constitution.

CHAIRMAN SAXE: I could take a little time in answering Judge Leser, but it is not part of the program. I would like to call his attention, however, to the fact that the supreme court has indicated that the fourteenth amendment is no protection so far as the banks are concerned, because it held in *Phelps v. the Union Trust Company*, the Alabama decision, that a state can separately classify national banks from state banks, and tax the one under the limitation upon the power granted by congress, and the other as it sees fit.

Our next subject this evening is one that is uppermost in the minds of a great many tax people. Judge Leser referred to the surplus in the United States treasury in 1837 under or by reason of which the government made a distribution to the states. But he didn't tell you that the government did it in order to avoid the undistributed profits tax.

In the November issue of *Harper's Magazine*, which has just come to the newsstands, you will find a most interesting article entitled "Our Tax Jungle" by Chester T. Crowell. It is an excellent picture of the frightful tax mess that this country is in, and I commend it to your attention.

At the end of the article, Mr. Crowell says, "Our tax jungle is not primarily the result of high taxes, they are still low relative to those of comparable nations, but of the absurd disequilibrium with its consequent injustice. Restoration of order and reason in the tax structure is what we need, and to get it is probably a ten-year job."

We need light to get out of the jungle, and the next speaker is one who is giving us light on the subject of taxation. As the former special adviser to the secretary of the treasury, and as the present adviser to the United States Chamber of Commerce on taxation, Mr. Alvord is leading tax thought in the correct direction.

I take great pleasure in presenting to you Mr. Ellsworth C. Alvord as your next speaker.

E. C. ALVORD (District of Columbia): Mr. Chairman, Mr. President, Delegates to the Conference on Taxation sponsored by the National Tax Association and Guests: The attendance tonight compels me to abandon everything which I had expected to say and embark upon an entirely different program.

The National Tax Association—and this is of no particular interest to the guests—and the delegates to the tax conference are confronted with a choice, a very important choice. In fact, I think they are in precisely the position of a home town friend of mine up in northern Wisconsin. Ole had been calling on Hilda for some time with considerable regularity. Hilda's father, consistent with the principles and ethics of the Scandinavian people, became very worried. He discussed the matter with Hilda at the breakfast table and asked Hilda whether Ole had suggested marriage. Hilda on each occasion would reply, "No, father, no talk about that yet."

Finally Mr. Stevenson, who was the father, could restrain himself no longer. He went down into the sitting room while Ole was waiting for Hilda to finish the dishes and he called Ole over to the stove. They discussed various subjects, and finally he said to Ole, "Now, Ole, you have been going with my Hilda for four or five or six weeks. What I want to know is, is your intentions honorable or dishonorable?"

Ole looked at Mr. Stevenson and he said, "My golly, Mr. Stevenson, do I have a choice?"

Ladies and Gentlemen, a foundling has been placed upon the doorstep of the National Tax Association. The advocates of the undistributed profits tax, both in sponsoring the original proposal, and in defending the tax which was enacted on the twenty-second of June of last year, quote in support of their position the statements of two of the most eminent past presidents of the National Tax Association and cite the action of the National Tax Association itself in 1927.

Perhaps, for the benefit of those who haven't had a chance to read the law recently, I had better review briefly just what the tax does.

It imposes a normal tax upon the income of corporations graduated up to fifteen per cent. It then imposes a penalty ranging from seven to twenty-seven per cent upon so much of the statutorily defined net income which is not distributed in the form of taxable dividends, within the taxable year, to the stockholders of that corporation. It then subjects all dividends to a normal tax of four per cent, and it imposes a tax upon dividends received by a corporation from another corporation at the rates I mentioned—except that for purposes of the corporate normal tax such dividends are to be included in income only to the extent of fifteen per cent.

That, roughly, gives you a picture of the undistributed profits tax.

As I say, in support of that tax, and in defense of it, they quote Dr. Thomas S. Adams; and if I were permitted more than one wish

this evening, my second wish would be that Tommie Adams were here among you to lead us again out of the jungle and give us the light which your chairman has suggested is essential.

Dr. Adams in 1920, as an official of the treasury department, recommended a tax program. His recommendations roughly were these. Reduce the existing tax rates to twenty per cent. Encourage the reinvestment of corporate earnings in the business of the corporation. Do not compel distribution. When distribution is made, give a credit to the stockholders corresponding to the taxes paid by the corporation.

Ladies and Gentlemen, if there were any possible ambiguity in the recommendations of Dr. Adams—and my memory goes back to the time that he made those recommendations—they would be most completely removed by his address before this association in 1923. In that address he said, in effect, "No, we shall not compel the distribution of earnings by corporations. We believe in the investment of those earnings in the business of the corporation. We believe in the expansion of the activities of business, and we think that the revenues of our government will be increased thereby."

Apparently, the present advocates and defenders of the undistributed profits tax, having misconstrued Tommie Adams' original recommendation, overlooked his address in 1923.

Then they cite Professor Fairchild. At about the same time Dr. Adams made his recommendation, Professor Fairchild recommended the abolition of the normal tax upon corporations—in fact, the abolition of substantially all taxes upon corporations. It was his theory that the corporation is but a conduit through which the earnings are earned and finally are distributed to the stockholders. It was his theory, too, that the stockholders should be taxed, and not the corporation.

"Consequently," he said, "let us tax the corporation only in a very small, inconsequential amount. We will impose other taxes upon the stockholder, and as a compensation for deferred payment, let us tax at a very small reasonable rate those earnings which are not distributed."

Fortunately Professor Fairchild has remained with us so that he can state his position. Those who find comfort and support in Professor Fairchild's early recommendations, which were made to lead the way out of the extraordinary war taxes, should read Professor Fairchild's testimony before the committees of congress. He unequivocally disavows any advocacy of the principles upon which the present law is based.

Then we come to the so-called action of the National Tax Association. In 1927 there was presented to this association a report by a committee on which Mr. George E. Holmes was the compelling force. Those of us who know Mr. Holmes know precisely what he intended when he presented his report. He also said, "The

corporation is but a conduit. Let us tax the stockholders, and let us then impose but a compensatory tax upon the corporation itself equal approximately to the interest on the individual taxes the stockholders were postponing by deferring the distribution." And he cautioned the association that that rate must be very, very low.

The advocates of the principles of the present law seemed to find support in what Mr. Holmes reported as chairman of the association's committee on simplification of the income tax.

So I say the association has a specific choice to make. I find no approval of the committee's report in any of the activities of the association. But nevertheless, it is said that the association approves the principles of the present law. It seems to me, therefore, that the National Tax Association is confronted with both an opportunity and a duty, to state specifically its position with respect to the undistributed profits tax in order that all possible doubt may be removed.

I am happy indeed if I can contribute in the slightest to the consideration of the principles of the undistributed profits tax by the delegates here tonight.

The president on the third of March, 1936, sent a message to congress. That message advocated a tax upon undistributed profits, and stated that a tax upon undistributed profits is advocated and recommended for three reasons:

First, we should equalize taxation of incorporated and unincorporated enterprises.

Second, we should equalize taxation of the income of corporations, whether or not distributed, in order to prevent avoidance by the retention of those earnings in the corporation.

Third, we should effect great simplification in our taxes.

Ladies and Gentlemen, there isn't anyone among you who would quarrel in the slightest with those three principles. They are principles for which the National Tax Association has been fighting for thirty years. Students of taxation have urged them and recommended them ever since the inception of the tax upon incomes. Why, even I endorse them! But, gentlemen, there is "something wrong somewhere." The pronounced and publicized purposes don't quite jibe with the recommendations for an undistributed profits tax. Either the real purposes were not disclosed or the wrong recommendations were made.

Consequently, I endeavored to find out which it was. A little research revealed a rather startling result. I found that long before the present administration adopted the principles of an undistributed profits tax, certain economists close to the administration had likewise advocated the principles of an undistributed profits tax. The names of two of those economists are well known to each of you, Professor Tugwell and Mr. David Cushman Coyle.

But, gentlemen, don't be misled. They were not interested in the raising of revenues. They didn't care about a sound revenue system. They were not concerned with problems of tax administration. They cared less for the practical problems confronting taxpayers. They were not attempting to prevent avoidance of taxes through retention of earnings in the corporation. And, I don't think they cared even about tax equality.

No, their principles were much broader and more fundamental than that. They were advocating control by the government over every phase of business activity. Economic planning was the phrase they used, and all business activities were to conform to that plan. Their basic principle, in so far as the undistributed profits tax was concerned, was this: They said, "We can't trust the management of corporations to reinvest corporate earnings which are not distributed to stockholders. We think they speculate, they gamble, and in addition to that, we believe there is grossly excessive over-expansion of productive facilities. The earnings of the corporation should be distributed to the stockholders. Let them decide how such earnings should be invested. If more money is needed by the corporation, let the managers prepare a registration statement and a prospectus and file it with the Securities and Exchange Commission. Then we have a branch of the government in control over what they plan to do."

Prof. Tugwell and Mr. Coyle, then, are the ones who advocated the principle of the undistributed profits tax, not as a tax measure, but to carry on and perfect the reforms—the so-called economic and social reforms—which they advocated. It is only by comparing the principles which they asserted with the tax as recommended to congress and as enacted, that I can find any consistency. The stated purposes, on the other hand, were mere camouflage, and were not the true reasons for the enactment of the undistributed profits tax.

Well, what are we going to do about it? On several occasions I have suggested that basic principles be agreed upon by which modern methods of taxation can be judged. I have also had the temerity to state certain principles which I regard as basic. By coincidence I happen to have mentioned ten. They have been printed on various occasions. I will run over some of them briefly.

For example, it has always seemed proper to me that a tax should be capable of reasonable ascertainment. The best mathematician in the country, ladies and gentlemen, can't compute your liabilities under the present law.

Second, it seemed to me that maybe we ought not to impose unreasonable and excessive burdens. But, gentlemen, a tax which is imposed by reason of circumstances beyond my control at an aggregate rate of thirty-two per cent, seems to me to be both excessive and unreasonable.

Then it seemed to me that maybe we ought not to discriminate too harshly among competitors. The circumstances of the man across the street from you and competing with you are necessarily different from yours. You may be stuck with a tax, and he may be freed from it.

Then I have asked why shouldn't we tax all business profits on substantially the same basis? Well, do you realize that banks, insurance companies, mutual investment companies, common trust funds, and even foreign corporations, are exempt from the tax? If the accumulation of appropriate reserves and the acquisition of appropriate surpluses out of earnings are suitable for a bank or an insurance company, why isn't it proper for a business enterprise?

Then I have heard through delegates to the National Tax Association that the avoidance of taxes was one thing to be guarded against. Gentlemen, administrative officials defend the tax upon the principle that it can be avoided. They will say, for example, that if you haven't the cash, declare a stock dividend, or a stock right, or some scrip, or give your stockholders an option under which they can take either cash or stock.

But don't take them too seriously. If you recall no more from my remarks to night, let me impress this upon you: there is not a single method by which it is alleged that the undistributed profits tax can be avoided that I can tell you with certainty will bring about that result. And I have a few volumes written on that which you can look up some day. I have never heard any answer to it.

Then it seemed to me that we ought not to interfere too much with ordinary business methods. Maybe I am old-fashioned. But I should think that the business policies and the dividend policies of businesses should be determined quite independent of tax liabilities. Gentlemen, in the conferences in which I participate daily, the first question is, "What is the effect upon our tax liabilities?"

Furthermore, if we are to have a sensible revenue system, I should think we ought to have it coordinated with our other taxes—related at least in part to the principles of other federal, state and local taxes. Take a look at your undistributed profits tax and see how it fits that principle.

Then—oh, these things may seem simple; they did to me—I thought that we should have a tax which is capable of administration, capable of administrative decision, susceptible of reasonable administrative regulations so that the taxpayer could find out what the law means. Gentlemen, the only kind of administration which anyone in position at the present time or at any time would dare adopt for the undistributed profits tax is to say, "Mr. Taxpayer, the answer is no." Regardless of what you want to do, they say, and they have to say, "The answer is no."

There is nothing ahead but controversy and litigation. If anyone would have asked me two years ago about the possibilities of the enactment of a law comparable in the slightest with the law enacted on the twenty-second day of June of 1936, I would have questioned their mentality. Gentlemen, you are compelled to make determinations before the end of the year which no one can make within years after the end of the year. And if you don't make them accurately a penalty is imposed upon you. If you try to make them accurately, and attempt to conform to the law in every respect, the bureau of internal revenue may find, three, four, five or six years afterward, that you have made an innocent mistake and they will impose a penalty on you by reason of that mistake. They may impose the penalty after your tax liabilities have been finally determined, after your conferences with the bureau and after litigation with the board of tax appeals and the courts.

Now let me attempt to state very briefly a few of the reasons why I oppose not only the principles recommended to the Congress in March of 1936, but the principles upon which the law as finally enacted must rest.

(1) It is not a revenue measure. It is not designed to raise revenue and it won't raise revenues;

(2) It violates every principle of taxation, and conforms to none;

(3) It cannot be administered;

(4) It jeopardizes employment, prevents reemployment, imperils all the work of our relief agencies, and is in direct conflict with sound policy of the administration that industry should absorb the unemployed;

(5) It promotes monopoly, and more than overcomes the continued efforts of the department of justice and the federal trade commission.

(6) It puts small business in a straight-jacket;

(7) It encourages, in fact almost requires, unsound financing, and will do more damage to the small investor than all the good which can possibly result from the serious efforts of the Securities and Exchange Commission;

(8) It discourages normal growth and expansion;

(9) It penalizes the payment of debts;

(10) It imposes penalties upon those least able to pay;

(11) It arbitrarily measures the penalty by an artificially defined, statutory concept of "undistributed net income," and not by the true or book income of the corporation—which is the only income available for the payment of dividends;

(12) It attempts to measure dividend-paying ability by the operations of a twelve-months' period;

(13) It compels a corporation to make a host of complicated calculations before the end of the taxable year, and penalizes errors subsequently discovered with a retroactive tax;

(14) It requires, unnecessarily, that all dividends be declared and actually received by the stockholders before the end of the year;

(15) It risks the income of those who have retired, by reason of age or disability, and who are dependent upon income from their savings, annuities or pensions;

(16) It thrusts the arm of the government into every undertaking;

(17) It denies to youth the opportunities which should be left open to them;

(18) And last, but not least, I cannot believe that "the overwhelming majority of the American people" will accept the Tugwellian doctrines and objectives upon which this tax is based.

CHAIRMAN SAXE: Facing the sign at the back of the room, that grand banner, I feel that we are having a really heavenly evening.

(The sign read, "St. Paul invites you.")

Allusion has been made in the president's address to the subject of bank taxation. The next speaker, M. H. Hunter, acting head of the department of economics of the University of Illinois, wrote a thesis on the subject of bank taxation which is one of the favorite works in my library on that subject. He knows taxation in all its phases, and I take pleasure in presenting Mr. Hunter, who will address you on the "Effects of Taxation on the Localization of Industry."

M. H. HUNTER (Illinois): Mr. Chairman, and the same group to which Mr. Alvord just spoke, except in somewhat reduced numbers: I must confess that I approach this group with some fear and trembling, because I remember very distinctly the meeting at Indianapolis last year. We had a paper there on the undistributed profits tax. I opened the discussion, and as one gentleman told me here about that meeting of the conference, "You started something, and we didn't get it finished all the rest of the conference."

I am going to try to play safe, however, this evening by speaking very briefly, and I shall talk upon a subject perhaps much less controversial than was the one which I talked about last year.

EFFECTS OF TAXATION ON THE LOCALIZATION OF INDUSTRY

M. H. HUNTER

Professor of Economics,
University of Illinois

A great many statements have been made concerning the relationship between taxation and the location of industry. In some cases, as in the establishment of "tax colonies" beyond the boundary of a municipality, the causal relationship is fairly evident. In

many of the statements, however, a causal relationship is assumed but with the presentation of no evidence to bolster such a conclusion. This is especially true in numerous conclusions in regard to the effect of the taxing policy of different states in regard to the location of industry therein. One state or another is said to be driving industry from it because of its "unwise" or "burdensome" or "crushing" system of taxation. Other states are said to attract industry by their "leniency" in taxation.

To date, comparatively little has been done to test the validity of such statements.¹ More than a year ago one of my graduate students, Mr. George Steiner, came to me to discuss a subject suitable for a doctoral dissertation. Mr. Steiner was formerly at the University of Pennsylvania. (I give this information because I want Senator Edmonds to know that he has been in Philadelphia. In fact, he grew up there, and in Simon N. Patten's institution he undoubtedly absorbed some of Patten's keen power of analysis.) Since Mr. Steiner's training had been both in statistics and in public finance, a study suggested by the topic of this paper, as applied to the states, appealed to him. What I shall present is largely the result of Mr. Steiner's work although I am given the credit of having supervised it. Mr. Steiner is now assistant professor of economics at the University of Indiana where he is engaged largely in research and, in the future, he hopes to continue further the study of this problem.

The plan of the study is simple. The first task was to measure industrial development in each of the selected states for the periods under consideration; the second was to measure the trend of the tax burdens upon industry for these same periods. To compare the results of the first study with those of the second should give some indication as to whether there is any direct correlation between changing tax burdens and the development of industry.

In an attempt to measure industrial development, it seemed wise first to measure the development of industry exclusive of manufacturing and then to study the development of manufacturing. The latter was desirable, first because data in regard to manufacturing is more complete, accurate and definite than that available for industry as a whole; and second, because many of the statements which have been made concerning the effect of taxation upon the location of industry have been especially directed to manufacturing concerns.

It must be admitted, of course, that some indices are more pertinent in the indication of development of industry than are others, yet in his selection Mr. Steiner limited himself to those which would

¹ Bulletins 1 and 3, published by the Bureau of Business and Economic Research of the University of Wisconsin, represent the best analysis of the truth of such statements. The studies were made by George L. Lefler and supervised by Harold M. Groves.

be of most significance. It will be of importance, here, to note the indices which were chosen, with, very briefly, the reason in each case.

Growth in population is, to some extent, an index of industrial development. Farm population has been relatively stable or on the decline, so that any increase in population would indicate industrial growth. It is generally known that the center of population and the center of manufactures has moved closely together, while locational shifts of industry and population have been closely related.

The aggregate income received by the population of a state is a good index of its production. Not only does it indicate the amount of production, but has some bearing upon industrial opportunity. The deduction of farm income from the aggregate makes income an even more accurate index of industrial development. The change in corporate net income, moreover, may be considered a pertinent index of industrial growth or decline. While income is important, the social wealth, and especially the per capita social wealth is an index of development. If the per capita wealth increases more rapidly than population, it is evidence of industrial growth. Another indication of industrial change is the quantity of electrical power sold to commercial consumers.

Merely to mention the indices used to measure manufacturing development will indicate their importance. A comparison of net income from time to time is, of course, indicative. Other important measurements are value added by manufacture, the value of the products manufactured, the average number of wage earners and wages paid in manufacturing establishments.

With this lengthy, but necessary, explanation we can now draw some conclusions for the states included in the study — Michigan, Indiana, Wisconsin, Illinois, Ohio, New York, Pennsylvania, Minnesota, Massachusetts, and the United States as a whole. Calculations were made for each index and the state with the best showing was given a rating of "1"; the next best "2", etc. to "10". In the sum of such rankings, the state which had the fewest points is considered to rank first in industrial development, the state with the next fewest, second, etc. [The summary of rankings for the states for the two periods is on the following page.]

The important question, for the purpose of reaching some conclusion as to the relationship of taxation to industry, is: what was the trend of the tax burden in these states during this period of industrial expansion and the one of retardation? Here again, rankings were made from the computations of many indices of varying merit.

Total state and local tax collections are not, of course, an accurate indication of the burden of taxes upon industry or upon individuals. Their trend, however, does have some significance when one state is compared with another. When general tax collections are related to population, income and wealth, they become a significant index

SUMMARY OF INDUSTRIAL DEVELOPMENT
1919-1929 AND 1929-1935

General Development									
1919-1929									
Ill.	Ind.	Mass.	Mich.	Minn.	U. S.	N. Y.	Ohio	Pa.	Wis.
1	7	10	1	9	6	5	3	8	4
Manufacturing Development									
1919-1929									
4	3	10	1	8	6	7	4	9	2
Combined Rank									
2	5	10	1	9	7	6	3	8	4
General Development *									
1929-1935									
8	3	2	1	4	7	6	10	4	9
Manufacturing Development									
1929-1935									
6	7	4	2	1	4	3	9	7	10
Combined Rank									
8	5	3	1	2	6	4	9	6	10

* Ranks for 1929-1935 show relative decline. Thus Rank "1" shows the least decline, etc.

of tax burdens. It must be remembered, moreover, that the taxes paid by industry are not the only ones which burden it. The taxes paid by a potential customer will effectually curtail his power to purchase goods. It appears desirable, then, to use total tax collections as one of the indices of tax burden.

The real burden of a tax is seen when one calculates the percentage of per capita income which is taken in taxes. Each of two states might take ten per cent of a social income of \$100,000,000. If, in one state, this income were distributed among a population ten times as great as in the other, the burden will be more keenly felt. A calculation, then, of the relation of taxes to social income becomes important in the measurement of tax burdens. Another index of some value is the relation of per capita taxes to per capita wealth, as also is one for per capita property taxes and per capita state and local taxes and the rates of collections from general property taxes to total state and local collections.

Of more direct significance for our purpose is a calculation of the tax burden upon all corporations. The ratio of state and local taxes to the net profit of all corporations, before the deduction of taxes was calculated from data compiled by the bureau of internal revenue. Especially in the case of manufacturing corporations, an

attempt was made to arrive at the ratio of property taxes to the value of the property. The ratio of state and local taxes to the net profit of manufacturing corporations was also calculated.

As a last basis for comparison of tax burdens a hypothetical corporation was set up. This had a certain capitalization, a certain valuation for its property, a certain income, etc. To this was applied the tax laws of the different states and a comparison made of the burden.

As in the measurement of industrial development, the results of the calculations of all these indices were combined into a ranking for the states under consideration. The state which accumulated the fewest points is indicated as having the lowest tax burden, and is given the rank of "1"; the state with the next number of points is given the rank of "2", etc. The ranking is as follows:

SUMMARY OF TAX BURDENS

1922-1929 AND 1929-1935

Ill.	Ind.	Mass.	Mich.	Minn.	U. S.	N. Y.	Ohio	Pa.	Wis.
General Taxes									
1922-1929									
4	5	7	9	3	8	10	5	2	1
Taxes on Manufacturing									
1922-1929									
1	8	9	6	6	4	3	4	2	10
Combination of Ranks									
2	6	8	10	4	7	9	5	1	3
General Taxes									
1929-1935									
8	1	9	4	7	6	10	2	3	4
Taxes on Manufacturing									
1929-1935									
1	5	8	7	10	4	2	3	6	9
Combination of Ranks									
8	1	10	3	7	4	9	1	4	6

We now have two sets of rankings—one for industrial development and one for tax burdens—for each of two periods. If one set of calculations is imposed upon the other, it will give some evidence as to the correlation between tax burdens and industrial development. The general conclusion that must be reached, when the ranks of general industrial development are compared with the general tax burden for the period 1921 to 1929, is that there is little correlation between industrial development and the trend of the tax burden.

In Michigan, for example, we found the greatest industrial development although at the same time she had the most rapidly increasing tax burden. The state of Pennsylvania had a relatively low tax burden, yet the industrial growth was smaller than in any of the states except Minnesota and Massachusetts. The results for the period 1929 to 1935 show the same lack of correlation. These, however, should be considered less significant since the period was an abnormal one, and it is entirely probable that conditions were endured when the factors responsible for them were looked upon as temporary. Had they been considered permanent, managers of industry might have acted differently. Thus one could argue that the reason why the great increase in taxes in some states seemed to have such an insignificant influence on industry was that it was thought these taxes would be temporary. Whatever the explanation, the indices show that in the four states in which industry declined the least, Michigan, Minnesota, Massachusetts, and New York, the tax burdens were the most severe, and, with the exception of Illinois, the states which showed the most rapid decline in industry had relatively light tax burdens. In both of the above periods, when manufacturing establishments alone are considered, the results are substantially the same.

Again the attention should be called to the fact that the above calculations, in each case, have been made within the boundaries of each state. It may be very possible that, other things being equal, to use a saving phrase of the economist, the size of the tax burden might cause an industry to locate on the shore of Lake Michigan in Indiana rather than in Illinois. Conversely, the explanation of the apparent lack of correlation between the growth of industry and low taxation lies in this same "other things being equal", or rather that they are unequal. It may even be possible that in those states with the highest tax burdens that industry is getting value received for its tax payments, for the expenditures of the states may be to the advantage of industry. Many factors other than taxation, moreover, influence the location of industry and it may be that their importance is so great as to outweigh the influence of the tax burden.

In the last part of his study, Mr. Steiner gives considerable attention to the relative importance of different locational determinants. Many industries have studied their own situation while many impartial studies have been made of these determinants both by individuals and by organizations. From these studies the following summary is some indication of the relative importance of different locational determinants for several important industries. Granted that, because of lack of similarity in data to be used and that some of the items are much more applicable as between localities than as between states, yet the indication is that taxation has played a relatively unimportant role as a factor in the location of industry.

SUMMARY OF LOCATIONAL DETERMINANTS¹ FOR CERTAIN INDUSTRIES

	Markets	Transportation	Labor	Raw Materials	Available Fact. Sp.	Personal Reasons ³	Power and Fuel	Cheap Rent	Near Related Ind.	Living Conditions	Financial Aid	Taxes	Mergers and Consolid.	Cheap Land	Near Parent	Geographical Conditions ²
Agricultural implements	2	1	4	3	5	..	..	..	..	..	..	..	..	6	..	..
Boots and shoes (other than rubber)	3	2	1	4	6	..	5	..	..	..	..	..	..	..	..	..
Bread and other bakery products	1	2	3	4	5	..	6	..	..	..	..	..	..	..	..	..
Cement	4	3	6	2	5	..	1	..	..	..	..	..	..	..	..	..
Chemicals, not elsewhere classified	..1	2	3	4	5	..	7	..	8	6	..	..	..	..	..	..
Cigars	2	3	1	..	4	..	..	5	..	..	..	..	..	..	..	..
Cigarettes	2	5	3	1	6	..	8	7	..	..	..	..	..	..	..	4
Clay products	1	2	3	..	..	..	4	..	..	..	..	..	..	..	..	..
Clothing, men's	2	..	1	..	..	..	..	3	..	..	..	..	..	..	..	..
Clothing, women's	1	6	2	..	5	..	3	4	..	..	..	7	..	..	..	..
Cotton goods	2	3	1	4	..	..	7	..	..	..	..	6	..	..	..	5
Druggists' preparations, medicines, etc.	1	2	4	3	7	5	..	6	..	..	..	..	..	..	..	..
Electrical machinery and equipment, etc.	3	1	4	2	5	..	..	6	7	..	..	..	..	..	..	..
Engines, turbines, motors, etc.	2	1	5	6	7	..	..	..	..	..	..	..	3	..	4	..
Flour and other grain mill products	3	1	..	2	5	..	4	..	..	..	..	..	..	..	..	..
Furniture	2	1	4	3	7	..	6	5	..	..	..	..	..	..	..	..
Glass	2	4	3	..	5	..	1	..	..	..	..	..	..	..	..	..
Knit goods	2	5	1	..	3	..	4	6	..	..	..	..	..	..	..	..

SUMMARY OF LOCATIONAL DETERMINANTS¹ FOR CERTAIN INDUSTRIES.—*Continued*

	Markets	Transportation	Labor	Raw Materials	Available Fact. Sp.	Personal Reasons ³	Power and Fuel	Cheap Rent	Near Related Ind.	Living Conditions	Financial Aid	Taxes	Mergers and Consolid.	Cheap Land	Near Parent	Geographical Conditions ²
Motor vehicles (not including motorcycles)...	3	2	4	1	5	..	..	..	6	..	7	..	..	..	..	..
Motor vehicle bodies and parts	6	3	5	2	7	..	..	..	4	..	..	..	1	..	..	..
Paints and varnishes	2	1	4	3	6	..	5	..	..	..	..	..	..	..	..	..
Paper and wood pulp	3	1	..	2	..	..	..	..	..	..	..	..	..	..	..	..
Petroleum refining	2	1	5	3	..	..	4	..	..	..	6	..	..	..	..	..
Rubber tires and innertubes	4	3	2	5	7	..	..	..	6	..	..	..	1	..	..	..
Silk and rayon	3	2	1	..	5	..	6	7	..	..	..	..	..	..	..	4
Slaughtering and meat packing	2	3	4	1	..	..	..	..	..	5	..	..	..	..	..	..
Soap	3	2	5	1	6	..	4	..	..	7	..	..	..	..	..	..
Steel works and rolling mills	3	2	4	1	..	..	..	5	..	..	6	..	..	7	..	..
Woolen goods	2	4	1	3	..	..	5	..	..	..	..	..	..	..	..	..
Worsted goods	2	4	1	3	..	..	5	..	..	..	..	..	..	..	..	..

¹ A rating of 1 signifies that the locational determinant under which this figure is placed is the most important influence in situs. Similarly a rating of 2 signifies the second most important locational influence, and so on.

² This includes humidity conditions, types of water, etc.

³ The personal reasons listed for druggists' preparations, etc., refers to the desire to use New York as a point of manufacture for advertising purposes.

CHAIRMAN SAXE: The meeting is now open for discussion. Gentlemen will please observe the rule of the conference. Those who desire to speak will please come forward and give their names to the reporter.

FRANKLIN S. EDMONDS (Pennsylvania): Mr. President, I have listened to Dr. Hunter's paper with very great appreciation. In my youth I had two remarkable teachers in the field of economics. One was Simon N. Patten and the other was Edmund J. James, who became the great president of the University of Illinois and created the department of economics of which Dr. Hunter is now a distinguished ornament. These men were great thinkers, and I am very sure that it would give joy to their hearts to know that the University of Illinois was engaged in making such an interesting study.

I want to call Dr. Hunter's attention to the fact that the comptroller of the city of New York has recently published three reports showing industries are fleeing from New York City. They consist of the most extensive study along that line that I have seen for sometime.

Also the general assembly of Pennsylvania has appointed a committee, perhaps not with so definite a mission as in New York, because they are seeking first to inquire whether industries are fleeing from Pennsylvania, and if so, where.

I should say that the conclusions that you have already found as to the relative weight of taxation are probably borne out by both of these inquiries. Taxation becomes a serious cumulative argument where other arguments exist. Where the other arguments do not exist, perhaps it is minimized for the time being.

Moreover, it seems to me that we ought to make a special study of those industries that have greater mobility, rather than those of less mobility. A manufacturer or a utility would find it rather difficult to pull up stakes. A wholesale house can do so. It is comparatively easy for a wholesale house which distributes through a half-dozen states to remove from one distributing center to another, if the burden of taxation in that one center becomes great.

I have a feeling that eventually there will be a study which will be applied to those businesses that can be readily removed. I think also, it is to be borne in mind that in the period from 1929 to 1935, very few industries considered removing. Existence was the problem they were concerned with during that period. I think in order that the study may be complete, it will be necessary to carry it on for a period of perhaps five years from 1935 when under happier conditions business can commence to make long-range planning for the future.

I am inclined to think that when that study is made it will be found that business is seeking the locality, not where the taxes may

be lowest, but where the tax administration is the simplest—places where they do not run the risk of having unfair penalties applied upon them, through ignorance of some particular peculiarities of the law.

Mr. Alvord used some very forceful language in describing the undistributed profits tax. I wish that he would turn his vocabulary upon that new business license tax in the District of Columbia which provides a penalty of \$1,000 a day for failure to register, when the license fee is but \$10. Just exactly under what circumstances, what particular mind conceived this system of equity, I do not know. My vocabulary is not equal to it. Mr. Alvord's may be.

I want merely to conclude by assuring Dr. Hunter that when at Indianapolis last I referred to the teachings of Dr. Simon Patten, that, sir, was not a tirade. It was a gentle admonition. If you want a tirade, get me talking about the new deal.

CHAIRMAN SAXE: Is there any other delegate who desires to discuss any of the papers?

MR. HUNTER: Mr. Chairman, may I have just one minute, please?

I want to say that I am in hearty agreement, absolutely, with Senator Edmonds. In one page of the manuscript I say exactly as he said about the second period of 1929 to 1935. I think any trend that might be pointed out really doesn't mean anything. But I do think that we ought to go much further in the studies.

The second, and one to which I called your attention very definitely, is that, this is merely a study of nine states. It does not go into the shift of industry from one city to a neighboring city or from the center of a city to the outskirts of a city. Taxation, I think, very definitely may have an influence there which would not show up from one state to the other.

CHAIRMAN SAXE: Is there any other gentleman who desires to discuss any of the papers? If not, the chair will entertain a motion to adjourn.

(A motion was duly made and seconded, whereupon the meeting adjourned.)

SEVENTH SESSION

WEDNESDAY, OCTOBER 27, 9:30 A. M.

PRESIDENT LESER: The conference will come to order.

I just received from Secretary Query the pleasing information that the attendance at this conference from non-host states is the largest recorded attendance in our history. He didn't give me any explanation of that fact, but I have worked out one for myself. It is because it was known that the presiding officer today at this session would be the celebrated Harry O. Levin, of Maryland, my successor on the state tax commission.

I present the chairman for this session.

HARRY O. LEVIN, presiding.

CHAIRMAN LEVIN: There will be some announcements by Mr. Query.

SECRETARY W. G. QUERY: The chairman of the committee on double domicile in inheritance taxation has requested me to announce that a meeting of his committee will be held at two-thirty today in room 638 of this hotel.

The personnel of the committee is Seth T. Cole, New York, William D. Kelly, New Jersey, William H. H. Gentry, California, Raymond D. Thomas, Oklahoma, and chairman Farwell Knapp of Connecticut.

I wish to make one other announcement. Most of you know, of course, that we are very glad to receive new members into the National Tax Association at this conference. We have already enrolled thirty new members, but I wish to state for the benefit of those who are not members of the association that for \$5 you receive a copy of the *Proceedings* of this conference, as well as nine issues of *The Bulletin*. I would like to see the membership at this conference increased by at least fifty, and I hope all those who are interested in the work of the association and in this conference will go to the secretary's desk and pay \$5 and we will enroll you as a member.

I think Judge Leser was modest in making the statement that he made a few minutes ago. There are a good many elements that make this the largest non-host-state-attended conference in our history. The program is a most excellent one. The inquiries that have been coming to me for the last two or three months indicated that there was increasing interest in the work of the National Tax Association.

It is very gratifying to me to know and be able to state, as Judge Leser has stated and which I repeat, that the enrollment of delegates from the non-host states exceeds any record of previous conferences.

CHAIRMAN LEVIN: Ladies and Gentlemen, this being the first conference that I have had the pleasure of attending, it is naturally a great honor and I feel it quite a distinguishing feature as far as my own self is concerned to be permitted to preside at one of these meetings. Of course, I realize that I was not selected for this honor because of any excellence on my part but out of deference to the official position which I hold.

As Judge Leser stated to you, I happen to be the one who was appointed by the governor to succeed him, and my position in attempting to administer the tax laws of the state of Maryland has been, as you may well imagine, made more difficult by the fact—much more difficult—that I have succeeded Judge Leser, a recognized authority on tax questions and known throughout the length and breadth of every hamlet in the state of Maryland and unquestionably throughout the United States.

This morning you have a very interesting program, and quite in line with the program throughout all of the sessions. I have in mind that the duties of the presiding officer are not to take up the time himself, but to introduce the speakers. It is a matter of great regret to me that I have been deprived up until this morning of the pleasure of having met personally any of these gentlemen whom I am about to introduce, but notwithstanding that, their reputations have preceded them and I can assure you, ladies and gentlemen, that the program this morning will be of the highest interest.

The first gentleman, who is to speak on state tax legislation for 1937, which is a matter that is discussed at every conference, is a well known and capable attorney of the District of Columbia. It is fitting that there ought to be a discussion of state tax legislation throughout the United States, especially this year, because so many of the legislatures met in 1937. It is particularly interesting, and should be interesting to those of us interested in tax matters, that a brief summary be made of the legislation which has gone into effect.

In the state of Maryland there have been a number of innovations, and one of them is an income tax of one-half of one per cent, which was touched upon by Judge Leser the other night. Incidentally, you gentlemen may have read in this morning's paper a statement by the assistant comptroller of this state in line with the discussion by Governor Cochran the other day in which he, Mr. McCusker, the deputy comptroller has announced that he thinks that all state employees of this state should be obliged to pay the state income tax.

Whether that feature was contemplated by the legislature or by the governor I do not know, but it is mighty interesting to see that

question raised because, in the last analysis, the court of appeals will be the appellate body to construe the income tax act.

Without taking up any more of your time, ladies and gentlemen, I want to introduce to you Raymond E. Manning, of the District of Columbia.

STATE TAX LEGISLATION, 1937

RAYMOND E. MANNING

Washington, D. C.

Legislatures in forty-six states met during 1937 and enacted approximately eleven hundred tax laws.¹ They adopted at least twenty-five new taxes, continued numerous taxes scheduled to expire, and revised upward many others. Among the new taxes are two sales taxes, eight use taxes, three gift taxes, two personal income taxes, two corporate income taxes, two chain store taxes, and one cigarette tax.

Before proceeding to discuss the tax-raising measures and to relate the new laws on property taxes, there will be presented several laws of general interest.

An important administrative change was effected in Oklahoma in reducing the membership of the tax commission from three to one. The enforcement of certain tax laws in Alabama, Connecticut, Idaho, New Mexico and Oklahoma is transferred from agencies whose functions are concerned essentially with other matters to agencies more particularly administrative. South Dakota vests administration of liquor taxes in the secretary of agriculture. Massachusetts abolished its board of tax appeals and created an appellate tax board of five members (former board had three members), and permits decisions by a single member under certain conditions.

Studies in taxation are provided for in the District of Columbia, Massachusetts, New York, North Carolina, Ohio, Pennsylvania, Rhode Island and West Virginia.

California permits other states to sue in California for taxes due to them, if a like comity is extended to California.

Taxes paid under protest in Illinois will be transferred to the appropriate fund 30 days after protest payment unless the person protesting secures a temporary injunction restraining such transfer, in which case the payment will be held in the protest fund until final order of the court.

¹ This paper includes legislation up to approximately Oct. 15, 1937. At that time, special legislative sessions were being held in Tennessee, Texas and Wisconsin. Included in the number of states that met in 1937 are Alabama, Kentucky and Virginia which, although not meeting in regular sessions, concluded special legislative sessions that commenced late in 1936. The results of any computation of the number of laws depend entirely on the view taken as to what is a tax law. For the purpose of this paper, professional licenses and levies under the police power generally are excluded.

GROSS INCOME OR GENERAL SALES TAXES

Two states have been added during 1937 to the list of those having sales taxes, viz., Alabama² and Kansas. These bring the number of states having the modern type sales tax to twenty-three.³ Existing laws were rewritten in Arkansas, Missouri, North Carolina, North Dakota, Oklahoma, and Wyoming. The Kansas law is permanent; so too are the revised laws in Arkansas and Wyoming, and amended laws in Iowa, Ohio (late in 1936), West Virginia, and Wyoming. The North Carolina Revenue Act is revised biennially, and the other laws noted above will expire as follows: Alabama—September 30, 1939; Missouri—December 31, 1939; Oklahoma—June 30, 1939.

Rates under the new laws in Alabama and Kansas are 2 percent except that a special $\frac{1}{2}$ of 1 percent rate will be charged in Alabama for new automobiles. Increases have been effected in Missouri from 1 percent to 2 percent, in South Dakota from 2 percent to 3 percent; in Illinois, the scheduled 1937 reduction from 3 percent to 2 percent has been postponed until February 14, 1939. In Arizona, the gross income tax has been amended to reduce the rate on manufacturing from 1 percent to $\frac{1}{4}$ of 1 percent, and to prescribe a 1 percent tax on contracting and $\frac{1}{4}$ of 1 percent on poultry raising and trading. Amendments to the Indiana gross income tax eliminate the levy on manufacturing and production, impose a rate of $\frac{1}{4}$ of 1 percent on wholesale sales, and increase the exemption of retailers from \$1,000 to \$3,000. In Washington, the rate on wholesale distributors has been reduced from $\frac{1}{2}$ of 1 percent to $\frac{1}{4}$ of 1 percent.

Sales of tangible personal property are taxed under all the new and amended laws. Admissions, telephone, telegraph, gas, and electric and restaurant service are taxed in Kansas, Missouri, and Oklahoma. Alabama also taxes admissions, Kansas and Missouri include water, Kansas taxes heating service and Missouri and Oklahoma exact duties for certain transportation services. Oklahoma, in addition to the foregoing, has a supplementary list, e. g. advertising, printing, hotels, apartments, parking lots, furnishing of labor, supplies, materials or services in the performance of contracts, etc.

In the District of Columbia, persons carrying on any trade, business, profession, vocation or commercial activity, except railroads, express companies, street railways, gas, electric and telephone companies, banks and insurance companies, will pay a tax for the year 1937-1938 of $\frac{2}{3}$ of 1 percent on their gross receipts in 1936 in excess

² Alabama adopted its first law in December 1936, but this was replaced early in 1937 by a new act.

³ Ala., Ariz., Ark., Cal., Colo., Ill., Ind., Iowa, Kan., La., Mich., Miss., Mo., N. M., N. C., N. D., Ohio, Okla., S. D., Utah, Wash., W. Va., and Wyo. A 1 percent tax was adopted in Maine for submission to referendum during 1937; it was rejected.

of \$2,000; a credit is allowed for tangible personal property taxes paid during the 1937-1938 fiscal year.

Supplementing the retail sales tax, Colorado has imposed a tax of 2 percent on the value of every service rendered or performed in the state for the ultimate user. It includes amusements, hotels, construction, professions, trades, etc. But where the services become a part of a manufactured product subject to a retail sales tax, they are exempt. Telephone, telegraph, power and light services already subject to the retail sales tax are also exempt. The act is to expire June 30, 1939.

A revised utilities sales tax was adopted in Illinois to replace that held unconstitutional. It applies to telephone, telegraph, gas and electric service; water is exempt. The rate is 3 percent.

An unusual feature is found in Missouri which allows retailers to retain 3 percent of their remittance to the state.

A protection is afforded Illinois bidders on public contracts by a provision under which certain institutions, for the purpose of determining the lowest bidder, shall add an amount equal to the sales tax to bids submitted by persons not liable for the tax.

Use taxes have been adopted by Alabama, Iowa, Kansas, Michigan, Oklahoma, South Dakota (automobiles), Utah and Wyoming. The Washington compensatory tax was revised to overcome objections of federal courts; hereafter, the tax will not apply until transportation has finally ended or until the article becomes commingled with the general mass of property. Newsprint has been excepted from the California law.

GASOLINE TAX

Rates of gasoline tax were increased by 1 cent in five states, viz., Minnesota, Missouri (effective December 7, 1938), New York, Rhode Island and West Virginia. Temporary rate increases scheduled to expire were continued in five states, viz., Florida, Nebraska, New York, Ohio (late in 1936) and Pennsylvania.

A use tax of 3 cents per gallon is imposed by California on motor fuels not subject to the regular gasoline tax; this is designed to reach diesel and other fuels. In New Mexico, a tax of $7\frac{1}{2}$ cents per gallon (regular tax is 5 cents) is imposed on petroleum, other than motor fuel, used for propelling vehicles.

Motor vehicle fuels in excess of 20 gallons brought into Kansas in supply tanks of motor vehicles are made subject to the state tax.

Maine grants an additional 1 percent loss allowance on all transfers in vessels or tank cars from one place of business to another; but the total allowance shall not exceed 2 percent. A 3 percent allowance is to be made in New Mexico for evaporation and losses; the 1 percent allowance in California has been repealed. The 2 percent discount for prompt payment in Pennsylvania is retained for

the first \$50,000 but is graduated downward to $\frac{1}{2}$ of 1 percent on the excess over \$100,000.

One of the most noteworthy changes in the use to be made of the gasoline tax proceeds was the elimination in South Dakota of the diversion of one-half the total receipts to the rural credit fund; under the law as amended, the state highway fund will receive seven-eighths of the proceeds and the county highway and bridge fund will receive one-eighth. New York's continuance of the 1 cent general fund levy together with an additional 1 cent tax for the same purpose makes the total now diverted to the general fund 2 cents (the total tax is 4 cents). Illinois has diverted \$2,000,000 for schools while New Jersey has diverted \$7,917,660 for unemployment relief.

A Wisconsin resolution sought a conference with nearby states looking toward establishing a uniform tax rate, while an Alabama act authorizes the tax commission to negotiate reciprocal agreements with bordering states to cover collection of taxes on gasoline sold across state lines.

Maryland authorizes collection of a tax from sales made within federal territory situated within exterior limits of the state.

ALCOHOLIC BEVERAGE TAXES

With a few exceptions, the many changes in liquor tax rates have been upward, in some cases quite radically. No attempt will be made here to set them out.

The twenty-first amendment to the federal constitution repealing prohibition has opened the way for quarrels among the states. Pennsylvania and Rhode Island provide for equalizing the burdens on products coming from states that tax Pennsylvania and Rhode Island exports. In Missouri, the importation of liquors will be forbidden from states that the attorney general finds to be discriminating against the Missouri product.

TOBACCO TAXES

Vermont has joined the list of states having taxes on cigarettes. Laws imposing cigarette taxes have been continued temporarily in Connecticut, Oklahoma and Pennsylvania. In Georgia, the tax has been raised to 3 cents per 20, while in Vermont, under its new law, the rate is $1\frac{1}{2}$ cents per 20.

AMUSEMENT TAXES

A theater tax act in Montana exacts $1\frac{1}{4}$ percent of the gross proceeds in excess of \$3,000, and in Maryland, the tax on admissions to places of amusement is continued for two years more. A 15 percent levy will be placed in Arkansas on advertising prizes and similar business stimulants, including theater bank awards. New

York has amended its law taxing boxing gross receipts to include receipts from the sale of broadcasting and motion picture rights.

TAX ON STATE PRODUCTS FOR ADVERTISING

Florida's 1935 taxes on citrus fruits for their advertising have been continued. Washington has followed with a special tax-financed advertising program for apples. Both Maine and Idaho will advertise their potatoes with the aid of revenue from a tax thereon; the Idaho law also extends to apples, prunes and onions.

INHERITANCE AND GIFT TAXES

The year has been featured, so far as death duties are concerned, with a substitution by Arizona of an estate tax for an inheritance tax—rates 2 to 20 percent—new increased rates in Connecticut, Minnesota and New Hampshire, and continued application of temporarily increased rates in Massachusetts and New York.

Interest may also be centered on several laws of more than local importance affecting intangibles. Michigan has joined with other states providing for reciprocal enforcement of domiciliary death taxes. California has empowered its controller, with court approval, to compromise taxes on estates where a claim is made that the decedent was not domiciled in California. Colorado has a new provision to the effect that intangibles having an actual situs or business situs in Colorado but taxed at the state of domicile, are exempt from the Colorado tax only if 30 days' notice is given of intention to pay the tax at the domicile.

Gift taxes this year assumed more importance than ever before, three states, viz., Colorado, Minnesota and North Carolina having joined with the three already having them (i.e. Oregon, Virginia, and Wisconsin). Rates, graduated according to the amount of the gift and relationship of donor and donee, range from 2 to 16 percent in Colorado, $\frac{3}{4}$ to 35 percent in Minnesota, and 1 to 25 percent in North Carolina. Wisconsin has given continued life to its temporary law.

PERSONAL INCOME TAXES

Two new personal income tax laws were adopted in 1937, viz., Colorado and Maryland, the latter to be in effect for two years only. These bring the number of states having personal income taxes to thirty-one.⁴ Constitutional amendments authorizing income taxes will be submitted to referendum in Maryland, Pennsylvania and Washington, and referred to a second legislative session in Tennessee. Of general interest, too, are statutory amendments in Kansas and South Dakota extending their acts to income derived

⁴ Ala., Ariz., Ark., Cal., Colo., Del., Ga., Ida., Ia., Kan., Ky., La., Md., Mass., Minn., Miss., Mo., Mont., N. M., N. Y., N. C., N. D., Okla., Ore., S. C., S. D., Utah, Vt., Va., W. Va., and Wis.

by nonresidents within the state and a change in California under which a person spending nine months (instead of six) in the state is deemed a resident.

Rates for personal income taxes were revised upwards, but in no case very radically. Minnesota's 10 percent maximum is the high for 1937 legislation. Wisconsin retained its emergency surtaxes (thus giving it one of the higher rates) and also continued the privilege dividend tax. Temporary increases were continued in Massachusetts and New York; the latter also renewed its tax on unincorporated business. The range of rates under the other new and amended laws is as follows: Colorado 1 to 6 percent, Georgia, 2 to 7 percent, Maryland $\frac{1}{2}$ of 1 percent (flat rate), Minnesota 1 to 10 percent, North Carolina 3 to 7 percent, West Virginia 1 to 4 percent. It should be noted too that Colorado imposes a 2 percent surtax without exemption or deduction on income from intangibles. In Tennessee, the exemption accorded income from the stock of corporations assessed by Tennessee on 75 percent or more of their property has been repealed and a tax of 4 percent imposed thereon while the tax on income from bonds and other stocks has been increased from 5 percent to 6 percent.

Taxable income is broadened in North Carolina and Vermont to apply to certain annuities. In Minnesota a 50 percent tax is assessed on annuities reserved by grantors from gifts to three educational institutions whose property is exempt under territorial corporate charters. Massachusetts will continue to tax dividends, other than stock dividends, for another two years.

Exemption and deduction provisions has been variously amended. Of greatest interest probably is legislation in New York which repeals the exemption to constitutional state officers and, in effect, provides for taxing the salaries of federal employees performing nonessential governmental functions. The new Colorado and Maryland laws accept the exemptions allowed under the federal revenue act (\$1,000, \$2,500, \$400), while Georgia reduces its exemptions to this level. Increased exemptions are given in West Virginia (\$1,000, \$2,000, \$300 in place of \$600, \$1,300, \$200) and Iowa which grants the exemption in the form of a deduction from the tax (\$10, \$20, \$5 instead of \$6, \$12, \$2). Minnesota has substituted deductions for exemptions (\$10, \$30, \$5 instead of \$1,200, \$2,000, \$250) while North Dakota reversed the procedure \$500, \$1,500, \$200 instead of \$5, \$15, \$2). In California, the exemption to married persons is applied to persons contributing to the support of former spouses.

Capital gain and loss provisions were adopted or affected in Colorado, Delaware, Maryland, Minnesota, New York, West Virginia and Wisconsin. Of especial interest is the provision in the new Maryland act limiting recognition of gains and losses to those re-

sulting from property held less than two years. The new Colorado act and a Minnesota amendment follow the federal practice.

The credit or exemption for dividends from corporations doing business within the state has been repealed by Minnesota and Mississippi. Reductions of farming losses from other business income will be limited to \$500 in North Dakota. In Idaho, net losses from farming or raising livestock may be taken during the succeeding two years.

CORPORATION INCOME TAXES

Two new corporate income tax laws were adopted in 1937, viz., Colorado and Maryland, the latter to be in effect for two years only. These bring the number of states having corporate income taxes to thirty-two.⁵ In addition, California imposes a 4 percent levy on corporations not subject to the bank and corporate franchise tax act. The Pennsylvania corporation income tax has been continued for an additional two years.

Rates for corporation income taxes have been in some states revised upwards. Under the new and amended laws, they will be as follows: Colorado 4 percent (6 percent on banks and loan associations); Georgia 5 percent; Maryland $\frac{1}{2}$ of 1 percent; Minnesota 7 percent (6 percent after 1938); Montana 3 percent; North Dakota 3 to 6 percent; Pennsylvania 7 percent (a reduction from 10 percent); Tennessee 3.75 percent. In addition, temporary levies have been continued in Massachusetts, New York and Wisconsin.

Deductions, exemptions, credits, etc. allowed corporations have been altered by miscellaneous acts, as follows: California and Missouri will allow deduction for charitable contributions up to 5 percent; Colorado will exempt 85 percent of dividends from other corporations; Minnesota will allow a credit up to 10 percent of the tax dependent on the amount of property and payrolls in Minnesota; New York will permit a deduction of a part of the interest on indebtedness paid to stockholders or relatives; Tennessee withdraws the credit for certain taxes paid; Utah repeals the exemption to interest on obligations of the several states and the United States.

OTHER CORPORATION TAXES

Delaware and New Jersey provide most of the interest under this title relating to other corporation taxes. Designed to increase greatly Delaware's revenue from the franchise tax, an amendment takes away the right to group low par shares into units of \$100 and corrects the inequality under which corporations with no par or \$100 par stock operated. In New Jersey, the 1936 franchise tax was repealed and there was substituted a new tax applying the same

⁵ Ala., Ariz., Ark., Cal., Colo., Conn., Ga., Ida., Ia., Kan., Ky., La., Md., Mass., Minn., Miss., Mo., Mont., N. M., N. Y., N. C., N. D., Okla., Ore., Pa., S. C., S. D., Tenn., Utah, Vt., Va., and Wis.

rates as those on domestic corporations to that proportionate part of the foreign corporation's issued and outstanding capital stock as the New Jersey gross receipts bear to the total. Banks and utilities are exempt.

In Pennsylvania, numerous corporation taxes formerly paid after settlement by the department of revenue, shall be computed and paid at the time of filing the required returns. Another Pennsylvania change permanently removes the exemption from the capital stock tax formerly accorded corporations organized for laundering, processing and curing of meats, and manufacturing. North Carolina provides that foreign corporations shall pay their capital stock taxes at the time of filing their returns. Both states (North Carolina and Pennsylvania) also make changes in their allocation bases.

Oklahoma has adopted an act which declares that all processing taxes collected and now held or that hereafter may be received by manufacturers, wholesalers and distributors under the Federal Agricultural Adjustment Act will be forfeited to the state.

BANK TAXES

Colorado and South Carolina join the list of states taxing banks according to their net income. The rate is 6 percent in Colorado and $4\frac{1}{2}$ percent in South Carolina. Vermont subjects building and loan associations to a tax of 2 percent on their net income. In Minnesota, the gross earnings tax on trust companies has been jumped from 5 percent to 6 percent. Pennsylvania continues the eight-mill tax on bank shares, but repeals share taxes as to building and loan association stock. Pennsylvania has also repealed a law which forbade the appraisal of national bank stock at a figure higher than the current value in the market where the bank is located.

California allows financial corporations to set off license fees in computing their income tax. Kentucky exempts domestic building and loan associations from the income tax and Pennsylvania excepts credit unions from the bonus tax. In West Virginia, the $\frac{1}{2}$ of 1 percent gross income tax on banks has been repealed.

Banks having branches will be assessed on their stock in the several counties, cities or towns or districts of Nevada in the proportion which local deposits bear to the total.

North Dakota requests that congress permit states to tax national banks, provided the tax be no higher than on state banks. Wisconsin also memorializes congress to amend R. S. 5219.

INSURANCE TAXES

The rate on gross receipts of insurance companies in the District of Columbia is increased to 2 percent. Maryland has repealed the law taxing shares of casualty, surety, guaranty, fidelity, fire and marine insurance companies but has increased the tax with respect

to premiums of such companies to 2 percent. In Indiana, a new act imposes a tax of $\frac{3}{4}$ of 1 percent on the gross premiums of fire insurance companies. New York has changed the basis of taxing certain insurance premiums from the net retained basis to the direct basis. In Minnesota, insurance companies and investment companies are made subject to the income tax.

CHAIN STORE TAXES

New states adopting their first graduated chain store taxes are two in number, Georgia and Pennsylvania, while old states, three in number, Minnesota, Montana and South Dakota, have stepped up rates. Two interesting features of the 1937 laws are their application to theaters in Pennsylvania, and to mail-order houses at high rates in Georgia and Minnesota. Gasoline stations are exempt except in Montana where special low rates will prevail. The maximum rates applicable under the 1937 laws are: Georgia—\$200 on 40th store (\$10,000 on 5th mail-order house); Minnesota—\$350 on 151st store (\$1,200 on 11th mail-order house); Montana—\$200 on 6th store (\$37.50 on 6th gasoline station); Pennsylvania—\$500 on 501st store or theater; South Dakota—\$250 on 40th store.

Something new in chain store taxes is that found in Tennessee which imposes a tax of \$3.00 for each 100 square feet of floor space.

The graduated chain store tax of Maine was repealed.

PUBLIC UTILITY TAXES

Valuations placed on the tangible and intangible property of utilities in Utah by the public service commission shall be copied by the tax commission in valuing them for tax purposes, and the utilities shall be assessed in the same ratio as similar property to its true value. In North Dakota, consideration shall be given to reports to, and valuations by, the board of railroad commissioners, in arriving at valuations for tax purposes. In Illinois, a new law for assessment of railroads on the unit method of valuation has been adopted. North Carolina provides that in valuing fixed property, consideration must be given to the amount of earnings per mile of line within the state, and any other factor that would give a greater or less value per mile than the average value for the entire system.

New York imposes a temporary tax of 2 percent on the gross receipts of certain utilities to finance unemployment relief, and authorizes cities to impose a similar tax at the rate of 1 percent. Thus, the existing New York City tax is reduced from 3 percent to 1 percent. In Oregon, utilities will be required to contribute toward defraying the expense of their administration, by paying a tax on their gross intrastate operating revenues at rates not exceeding $\frac{1}{2}$ of 1 per cent for railroads and not exceeding $\frac{1}{4}$ of 1 percent for other utilities.

Transportation companies in Tennessee will be subjected to a 3 percent levy on their intrastate gross receipts; franchise and excise taxes will be allowed as a credit. In Pennsylvania, the temporary 20-mill rate is continued on certain transportation companies for 1937 and 1938. Minnesota increases its gross earnings tax rate on sleeping car companies from 5 to 6 percent, freight line companies from 6 to 7 percent, and express companies from 8 to 9 percent. Kansas substitutes a $2\frac{1}{2}$ percent gross earnings tax for all other taxes on private car companies. In Oklahoma, the tax commission is empowered to raise or lower the rate of tax on freight car companies so as to make the tax, as nearly as possible, the equal of the amount that would be collected if charged on an advalorem basis. California, North Dakota and Wyoming substitute state for local assessment of car companies, the basis to be the average number of cars in the state, and the rate to be 2 percent in Wyoming and the average local rate in California and North Dakota; the North Dakota law also applies to express companies and air transportation companies.

Airports privately owned in Oklahoma will be assessed a 2 percent gross income tax in lieu of all state and local property taxes.

Telegraph companies in North Carolina will be taxed 4 percent on the first \$1,000 of gross receipts and 6 percent on the excess; this is in lieu of the pole-mile levy. In Minnesota, a 7 percent gross receipts tax replaces that on telegraph property. The Minnesota law retains the 4 percent rate on gross receipts of telephone companies for rural business and business in the smaller cities but jumps it to 7 percent in other places; a uniform 6 percent duty will be in force if the foregoing is invalidated. In Montana, telephone companies will be subjected to a $1\frac{1}{4}$ percent levy on intrastate business. An emergency relief tax is levied in Wisconsin on the gross receipts of such telephone exchange for the calendar year 1936 which tax will range from 1 percent to $5\frac{1}{4}$ percent, the latter applying on receipts in excess of \$250,000; a tax on toll charges ranges from 1 percent to $4\frac{1}{2}$ percent, the latter applying on receipts in excess of \$25,000. The gross receipts tax rate in Alabama on telephone companies has been reduced from 4 to $2\frac{1}{2}$ percent.

The electrical energy tax in Montana on gross receipts has been increased from $\frac{5}{8}$ of 1 percent to 1 percent. Vermont subjects municipal corporations to its tax on electric energy. Tennessee imposes a tax on gas companies at the rate of $1\frac{1}{2}$ percent of their gross receipts. In North Carolina, the tax on the first \$25,000 of gross receipts of gas companies has been dropped from 6 percent to 4 percent.

TAXES ON NATURAL RESOURCES

A new severance tax in New Mexico exacts 2 percent on the gross receipts from oil and gas, 1 percent for potash, and $\frac{1}{8}$ of 1

percent for coal, gold, silver, zinc, lead, stone, copper, asphalt, and timber.

The tax in Minnesota on mining or producing iron or other ores has been increased from 6 percent to 10 percent for 1937 and to 8 percent thereafter, while the South Dakota levy on gold, silver, lead, tin and similar ores has been stepped up from 4 percent to 6 percent on production in excess of 100,000 tons (formerly 50,000 tons). Utah will impose a 1 percent tax on the value of ore produced from metaliferous mines in addition to the levy on the mines as property; the multiple, however applied against net earnings for placing the valuation on the mines as property is reduced from 3 to 2.

Christmas trees shipped out of Washington will be assessed a tax of 1 cent each. A tax in Minnesota of 1 cent on sales of such trees for use within the state is raised to 2 cents.

The one-eighth cent per barrel excise on petroleum produced in Oklahoma has been continued for 2 years, while the three-eighth cent privilege tax in Montana has been reduced to one-fourth cent.

POLL TAXES

Iowa repealed its \$2 old age assistance tax while Vermont increased its \$1.75 levy for that purpose to \$2.50. It may be noted that Vermont, to enforce collection, permits attachment of wages and suspension of motor vehicle operators' permits.

PROPERTY TAX RATES

Georgia has adopted a constitutional amendment authorizing classification of property and the adoption of different rates and methods for taxing the several classes. In North Carolina, intangibles have been segregated for exclusive state taxation at rates ranging from 1 to 4 mills. The Pennsylvania personal property and corporate loan taxes have been continued at the temporary 8-mill rate.

Indiana's rate limitation has been altered, the maximum outside municipal limits being raised to \$1.25 per \$100 and inside municipal limits to \$2; the amount which may be levied by the state is limited to 15 cents per \$100. It is also noteworthy that hereafter levies for bond and interest payments, including those for outstanding as well as future bonds, are excluded in the computations.

Motor vehicles in Arizona and Washington will be taxed in a manner similar to that inaugurated in California in 1935 and continued by a 1937 act. The idea is to impose a flat tax annually at a uniform rate in lieu of the regular property taxes. The rate in California is continued at $1\frac{3}{4}$ percent and fixed at 3 percent outside unincorporated areas in Arizona and 4 percent in cities and towns, and $1\frac{1}{2}$ percent in Washington.

EXEMPTION FROM PROPERTY TAXES

Homestead exemptions provide a real interest. Alabama allows a \$2,000 exemption from state taxes, Arkansas gives legislative effect to a \$1,000 exemption from state taxes, Florida submits a constitutional amendment to broaden the exemption base in a minor detail, Georgia exempts \$2,000 from state and local taxes, Iowa credits certain taxes to provide an exemption up to \$2,500 from state and local taxes, Minnesota exempts \$4,000 from state taxes (except for existing state debt levies). Oklahoma allows a \$1,000 exemption for all taxes (except for existing debt levies), South Dakota exempts homesteads from state levies and Wyoming grants a \$500 homestead exemption from all forms of taxation. In Maine, homes and personal property of blind persons will be exempt up to \$5,000.

A Georgia constitutional amendment exempts personal property up to \$300.

The property and bonds of housing authorities in Florida, Indiana, South Dakota, and Tennessee are exempted, but provision is made for entering into agreements for payments in lieu thereof. In New York, municipalities are authorized to exempt buildings and improvements constructed by January 1, 1947 in connection with elimination of certain housing conditions.

Business exemptions are to be noted. Alabama exempts manufactured products in the hands of the producer for 12 months after manufacture. A statute in Washington is designed to allow ports in that state to compete with Oregon by exempting for 6 months wheat, orchard products, and fish in transit or storage awaiting transportation outside the state. Hay, grain and other feed is exempted in Wisconsin. Delaware grants motion picture studios a 15-year exemption. North Dakota exempts drilling rigs and other oil and gas prospecting equipment for one year, West Virginia proposes by constitutional amendment to exempt manufacturing establishments from certain property taxes, and Wyoming relieves beet sugar factories from taxes for five years. Certain railways in Maryland are temporarily exempted from taxation, and rural electrification lines will be freed from South Carolina taxes. Property used in connection with California and New York World fairs are also scheduled for exemption.

Minor extensions of exemptions to veterans' organizations, religious societies, charitable institutions, etc. are noted for California, Florida, Kansas, Maine, Maryland, Tennessee, Texas, Vermont and Wisconsin. A tightening-up is evident in New Jersey and New Mexico.

The exemption of municipal property in Vermont shall not apply to sewage plants, sewers, mains, conduits, machinery, etc., used in connection with sewers.

Gifts to charity are not valid in Indiana if they provide for a payment of the income from such property to the donor unless the agreement by which such gift is made contains a provision that all taxes which the donor would have paid had he retained title be paid by him, or the institution that received the gift.

COLLECTION OF PROPERTY TAXES

More than half the states during 1937 have followed the practice established in recent years in waiving or reducing accrued interest and penalties, extending time for payment or redemption from tax sale, or permitting payments in instalments over a period of years.

A 1-3 percent discount for prompt payment has been ratified at a recent election in Texas.

A tax receivership law (similar to those of Illinois and New Jersey) has been adopted in North Dakota. Under it, on court order, rents from delinquent property will be paid by tenants to the county treasurer.

Public employees and other persons having claims against cities, etc., in Pennsylvania and owing delinquent taxes, will have their taxes deducted from sums due them.

CHAIRMAN LEVIN: It is too bad that Mr. Manning didn't take the entire time which was allotted to him, because that subject is very interesting. Watching him with his manuscript, I thought he was talking over the radio.

I now introduce Mr. F. M. Thrun, chief of the land use planning section of the resettlement administration of the state of Michigan, who will speak to us about standards of valuation for rural property.

THE DEVELOPMENT OF VALUATION STANDARDS FOR RURAL PROPERTY

F. M. THRUN

Chief, Land Use Planning Section,
Resettlement Administration of Michigan

The last thirty years have witnessed material improvement in the methods applied in determining the taxable valuations of urban real estate. Not only have the assessors' offices of our larger cities devoted the full time of a technically trained personnel to this subject, but other agencies interested in urban real estate problems have contributed their share toward the evolution of an appraisal technique. At the present time the National Association of Assessors is functioning most efficiently in keeping local assessors in contact with new developments in this field, and other agencies, such as the National Association of Real Estate Boards, as well as many schools and bureaus in universities, are systematically attacking the prob-

lems which arise in fixing urban city values. I shall not attempt, in the time which is available to me, to enter into an appraisal of the work which is being done along this line. It is self-evident, however, that there has been no similar development of appraisal technique to cover the tremendous rural areas which are being subjected to general property taxation.

From the point of view of the tax officials, whether he be the assessor or supervisory officer, it is just as essential that there be a careful supervision of rural assessments as it is that the assessments in cities shall be properly made. Yet it is safe to say that with very few exceptions little has been done in this direction, and that the great majority of assessors in rural areas do not have available to them an accurate inventory of the rural real estate which is under their jurisdiction. Until recently it has quite generally been considered sufficient to have available soil maps, and in better times to supplement this information with actual sales records together with valuation maps which presumably give consideration to location factors. This scarcity of factual data has been recognized from time to time and there have been occasional suggestions made looking toward more formal development of background material for rural assessors.

As early as 1907 the members of this conference were advised by Professor John H. McCracken of New York University that it was "futile to discuss improved systems of land taxation if we are to have one and the same law for farms and city lots." Three years later a committee on uniform classification of real estate reported to the national tax conference at Milwaukee that it agreed with Dr. L. G. Powers of the Bureau of the Census that tax maps ought to be provided, that rural lands should be classified into eight general classes, namely, (1) cultivated, (2) arable, (3) timber, (4) orchard, (5) waste, (6) mineral, (7) quarry, (8) oil and gas, and that parcels of rural property should be assessed acre by acre on the basis of the breakdown of the farm or other holding into these classes. It was further proposed that such items as topography and location be considered as variables affecting the results so obtained, and that buildings and improvements should be considered only to the extent that they enhance the value of the bare land. The following year the same committee reaffirmed its opinion that, to quote, "a tax map of some sort is a pre-requisite to equitable and scientific assessment work," but it added that the map might, to quote, "be merely an outline sketch map if nothing better is available." Regarding standards of value, the committee professed to see no need for determining a normal unit of area, citing the acre as the commonly accepted unit, but continuing to recognize location factors. Regarding buildings, the committee appeared to have reversed its original position and stated that, to quote, "The assessment of buildings in the country does not present problems differing

from assessment of buildings in the city, and the country assessor can use the same rules as the city assessor."

By the 1920s excessive taxes on farm property were generally cited as a primary cause of the agricultural depression which was being felt throughout the country, and the subject became one of the important questions to be discussed in these conferences.

I would like to quote a short paragraph from a paper entitled, "The Valuation and Assessment of Farm Lands," which was read by the Honorable H. L. Eveland, a member of the tax commission of South Dakota, at the St. Louis conference in 1924. I cite this paragraph because it demonstrates the increasing crystalization of views on rural assessment procedure, and because, while it summarizes in many respects the procedure which we are systematically applying to all farms in Michigan, I know of no other state where an equally thorough application of the proposal has been attempted in the intervening twelve years. Commissioner Eveland said:

"We believe that counties that undertake such work should have a record card system, similar to that in use in many cities in the assessment of lots and structures, and that such cards should contain provision for giving the character of the soil; presence of slope; presence of ravines, runs or streams; timber, if any; productiveness of soil; state of cultivation; drainage; whether or not tile has been laid where needed; distance to market; whether on main or traveled road or not, rural mail service; telephone service; church and school facilities; presence of railroad right-of-way and fences; character of surrounding lands and other conditions that have a bearing on value, and thereupon give each political subdivision of land a rating by number of letter."

The Michigan Rural Property Inventory Project was inaugurated in December of 1935 under the direction of the Michigan State Tax Commission acting in cooperation with the Resettlement Administration and the Works Progress Administration. To date approximately two million dollars have been expended. While this project is being carried forward in a state that no longer levies a state property tax, its results are confidently believed to be of general worth to the whole commonwealth. In the first place, one by-product alone, which resulted from the preparation of accurate tax maps, has been the elimination of thousands of faulty descriptions, many of them representing properties which had been omitted from taxation for periods of years. The mere systematic location of individual parcels of rural property on maps prepared for the purpose was sufficient to unearth many of these. Previous investigations by Mr. Newton and Professor Hedrick at Michigan State College had shown that many of these errors persisted in the tax rolls year after year without correction, and there is no question but that the sav-

ing in taxes spread on these faulty descriptions justify the cost of the whole project.

In addition to this beneficial result, Michigan, like many other states, has found it necessary in recent years to extend an increasing amount of subventions and grants-in-aid to local communities, and in the case of its school aid law, local capacity to carry the school tax burden, as represented by a valuation figure, is an important factor in determining the size of the state's contribution. The necessity for substantial equality of assessment procedure among the several assessing districts is even more important today than it was formerly, for the state is actually distributing for school purposes alone an amount of money which is twice as great as the property tax which it formerly collected.

Third, and finally, the state continues to owe to each taxpayer the assurance that any contribution which he may make through taxation to a public treasury by virtue of a state law shall be levied upon him equitably, both with respect to the total contribution of his community and with respect to the contribution of his fellow citizens in his own immediate locality.

At the time that our rural property inventory was commenced, reliance upon actual sales data had been virtually abandoned throughout our state. During the depression years sales were almost altogether of the type that could not be held to be transactions between willing buyers and willing sellers, and it necessarily followed that efforts to check assessed valuation figures degenerated into a comparison of one man's opinion with that of another. In urban areas where advanced types of assessment procedure had been adopted, the taxpayers had at least the satisfaction of knowing that they were being treated without discrimination as a rule within their own classes, but there was no such guarantee in the rural communities. It is probably safe to say that it is only the drastic reduction in property tax levels on farms and other rural property which prevented violent opposition to the assessment as they were being made. However, the taxpayers had the benefit of acts looking toward the virtual removal of road taxes in 1931 and 1932. This was followed in 1933 by the invocation of a tax rate limitation amendment to the constitution and the inauguration of a new series of state aids to local school districts and to the agencies of the government engaged in administering to the unemployed, thousands of whom had taken refuge in rural communities. In addition, township and rural school district officials were leaders in a general economy move which swept all the old established branches of government.

However, the problem of an improved assessment procedure seemed so urgent as to warrant the tax commission taking the initiative to interest the two federal agencies already mentioned in financing a general study which was designed to provide a background of records upon which a more systematic method of assessment could be based.

The work of this project has been carried on in eighty-two of the eighty-three counties. Wayne County, which is the most populous county in the state, was not made a part of the project because Mr. Albert E. Champney, director of the Bureau of Taxation of Wayne County, was already engaged in a joint county and federal project which was developing comparable data for all territory outside of cities in that area. While the methods employed in the Wayne County study differ in many respects from those employed by the state-wide project, the procedures were definitely correlated. Most of the differences are due to the overwhelming importance of site factors in the metropolitan area as contrasted with the primary concern with soil and topographical factors in the more genuinely rural districts.

The primary objective of the tax commission project in Michigan is to develop a system of permanent assessment cards of all property on the township rolls of the state. The detail of this card was finally determined upon after lengthy conferences and discussions with specialists in the field of taxation on the one hand and persons trained in soils and forestry on the other. The card provides space for the legal description and the name of the person to whom the property is assessed, a sketch of the dwelling, with space provided for entering details such as the year built, year remodelled, number of square feet, foundation, roofing, walls, type of construction, heating and plumbing, etc. In addition, location factors and other special features are entered, namely, type of road, miles to improved road, name of trading center and distance to it, distance to school, type of water supply, whether on a rural free delivery, telephone line, gas line or electric line. This part of the card is so designed that it may be used for rural dwellings or village structures.

Space is also provided for a map of the farm by field units. When completed this farm map shows the lay-out of fields, and for each field indicates whether it falls into one of the following classes, namely, cropland, wild hay, untillable pasture, all of which is grouped under Class A; Class B—special agricultural, such as onion, celery, mint, etc.; Class C—swamp; Class D—commercial orchards, vineyards and berries; Class E—non-agricultural, which is divided into forests and timber area, farm woodlot, cut-over land, sugar bush, marsh, lake, waste land, etc.

In addition, there is indicated on the field a quality rating for each class—the number of acres in each field and the detail as to soil profile to a depth of twenty-four inches, drainage, topography, and other features such as the degree of stoniness, prevalence of stumps, rock outcroppings, swale holes, etc. Below the map there is a summary table of the number of acres in each class of land according to quality ratings. In the case of forests and woodlots, in addition to the number of acres the table shows the prevalent type of forest growth, the number of board feet, cords of firewood,

stem count, and density. Also, there is space provided to indicate special types of land such as golf courses and other recreational developments.

A description of the main farm buildings is also entered with dimensions and twelve characteristic descriptive features listed for classification. Further, the amount, type and condition of fencing is shown.

The general organization of the project is as follows: from twenty to twenty-five tax commission field men have been assigned by the tax commission as a nucleus of the supervisory staff. In addition, on the project itself, there are employed field men who are assigned definite territory for supervision, and a staff in the central office which prepares the general plans, procedures and instructions and inspects the various county offices and the work in the field. These field men are mostly men trained in forestry, soils, or civil engineering.

The project has an office in each county seat in which the legal descriptions of the properties on the tax rolls are mapped and corrected through search of the records. When completed the maps are inked on tracing cloth and become the permanent record of the tax commission. Each piece of property on the rolls is given a code number so that future subdivision or integration in ownership of the property can easily be indicated by an addition to the code number. Incidentally, it may be of interest in this connection to state that there are approximately 1,500,000 individual descriptions on the township rolls, and to date fourteen per cent of these have contained major errors sufficient to invalidate the tax in the event it is not voluntarily paid. Seventy-six per cent of these errors have been corrected to date through clerical work alone. I might add further that this portion of the work has not been an inconsiderable amount of the total cost to date. The balance of the erroneous descriptions are of such a nature as would require the services of surveyors, and some counties are arranging to make these corrections at local expense, using the information obtained from this source for the purpose.

In each county a relief worker of proven ability has been placed in charge as office manager, who is responsible for the work in that office. In general, we have had excellent success in the selection of these persons. Most of the field foremen now on the project are relief people who have demonstrated their ability and capability of assuming responsibility while employed on the project, so that it has been possible to reduce considerably the non-relief supervisory staff.

Since the inception of the project to the 25th of October, 1937, there has been a total expenditure of \$2,001,033.73. The peak of employment was reached in October of 1936 when there were employed a total of 2312 people. At present this year the project has

been stabilized at approximately 1400 relief workers and 40 non-relief workers, not including the state tax commission field men.

Another indication of the magnitude of the undertaking may be shown by the fact that in addition to the field manual it has been necessary to prepare a detailed manual for the transcription of the field work to the final record cards, and approximately 200 circular letters and bulletins have been issued to the field supplementing the manuals, and approximately 80 administrative forms are at present in use on the project.

When the task of original compilation has been completed the state tax commission will have in its files a master roll showing all of the rural properties of Michigan, with extensive detail as to the exact condition and character of each, and duplicate records will be in the hands of each township assessing officer. Many of the facts at hand can be regarded as permanently determined except for occasional errors. Most of the remainder will be highly dependable for a considerable period of years even though no effort were made to keep the records up to date. We are confident that legislative support will be available, financially and otherwise, for keeping the records abreast of future changes, however, and are ready to submit plans covering this phase of the work.

The question which relates most directly to the subject assigned me for today remains to be answered, namely: how will this vast body of data be used in promoting a standardized assessment practice?

It must be clear to all that no one standardized procedure for fixing individual farm values can be given unqualified approval today, if for no other reason simply because no such formula has been sufficiently tested to warrant such an endorsement. This in turn is the direct result of the absence up to this time of such a body of information as we are gathering in Michigan. I do not wish to be misunderstood as casting any aspersions on any other research which has been carried on in this field, because of this last statement. I believe, however, that we have been fortunate in having in Michigan a combination of two factors which have not been brought into combination before. One of these, thanks to the Works Progress Administration, has been adequate financing and personnel, and the other is the presence in a restricted territory of one of the most highly diversified of all rural areas when classified on the basis of use. Rural Michigan includes corn, wheat and hogs in the south, and fruits in the east and west. Beans, potatoes, sugar beets, celery, peppermint, onions and chicory are grown, and most of these crops predominate some one or more areas, while dairying, poultry, beef and wool predominate in other sections. Add to this all of the transitional stages between the metropolitan areas surrounding the fourth largest city of the country, Detroit, onto the old established

farm land areas, through second-growth forests, cut-over lands to virgin timber, with the attendant recreational by-lines, as well as coal, iron and copper mining, and you have some idea of the diversity of the state.

Much of the soil evolved from ancient glacial lake beds, and it is not unusual to find a half-dozen different textures in a single ten-acre field. Within one county there may be farms with soil types that are usually found in widely separated localities.

It must be clear that methods of appraisal which would appear to work with reasonable accuracy under more uniform conditions would face the acid test here. And when it is remembered that no state, no matter how uniform its rural area, has adopted more than a general classification by way of valuation formula, I think you will agree with our conclusion that the first goal toward which we should strive is that of a standard basis for collection of facts, as represented by this survey.

I can say that the tax commission does not intend to follow up this work immediately with the promulgation of one or more formulae similar to the depth rule for city land or the cube or square foot measures for city buildings, with obsolescence and depreciation considered.

Such a procedure must wait at least until the assessing officers have had time to become thoroughly familiar with the farm records, and until it has been demonstrated that such measures are feasible.

For the present the attitude in Michigan is that both original assessment and review will be better done if the assessor has at hand the most complete information concerning each property it is possible to obtain, but that no rule for the application of this information to the individual farm has yet been demonstrated to be superior in operation to the assessor's judgment. Our data is proving of great value in enabling both the assessor and the reviewing officer or field man to draw fair comparisons of one property with another, but no mathematical formula has yet been tried which seems to take the proper factors fully into account.

I do not mean to suggest that efforts in this direction are being discouraged. On the contrary, a definite part of our study includes a systematic testing of various formula proposals, using areas considered most favorable for this purpose.

This phase of the work has not progressed very far as yet. A preliminary study is now under way in one of the townships, the intention being to make a rather intensive study of several valuation methods. This work has not progressed far enough to safely venture any definite conclusions, but preliminary inspection does bring to light some interesting facts. We are comparing four different types of valuation figures, namely,

1. Values derived by an appraisal method in which the various classes of land on any particular farm are given base values and the total value computed, and the replacement cost of buildings computed separately, using standard depreciation tables plus a percentage factor for location.

2. Valuation of the land computed as above, but buildings given a value in accordance with an experienced farm appraiser's estimate of the amount they add to the total value of the particular farm.

3. An average of estimated values given by farmers living in the neighborhood.

4. The present assessed value.

There is clear evidence that the application of formula methods to the improvements on the heavily improved farms leads to excessive valuation of those properties. The application of base values to soil types and the building up of total land values by this process leads to land values which, when increased by an amount representing an appraiser's judgment of the added value represented by buildings, corresponds reasonably well with neighborhood opinion. This, if further sustained, would indicate that it will eventually be possible to establish fairly accurate controls for bare land values.

None of these results are considered conclusive. All will be subject to extended further check, but they do illustrate the manner in which the Michigan commission is approaching the subject of standards of valuation for rural assessment. First emphasis has been upon the gathering of factual data; second, upon its dissemination to assessing and reviewing officials, and the first step in the careful, yes cautious, testing of formulae for its application by rule.

CHAIRMAN LEVIN: Thank you, Mr. Thrun, for that very interesting paper.

Last week when I was in New York at a convention of tax officers I had the pleasure of hearing a very learned and informative paper by the next speaker. He spoke on standards of valuation and it was a mighty interesting and valuable discussion of the subject. Today we will hear Professor Bonbright, of Columbia University, discuss public utilities.

JAMES C. BONBRIGHT (New York): Ladies and Gentlemen, had I known that this afternoon's session was to be devoted entirely to railroad valuation for tax purposes I would have confined my own discussion to the assessment of local public utilities, but I didn't know that and I must therefore ask forgiveness for trespassing on the subject of this afternoon's session.

THE VALUATION OF PUBLIC UTILITY PROPERTIES
FOR TAX PURPOSES

JAMES C. BONBRIGHT

Professor of Finance, Columbia University

Before discussing the subject assigned to me—the basis of public utility valuation for tax purposes—let me state my opinion that the best basis is no basis at all. I mean that I believe the *ad valorem* taxation of utility properties to be unsound. Indeed, a strong argument can be made for the exemption of certain utilities from all taxes save excess earnings taxes. But even if this extreme position is not accepted—and I myself am not yet ready to accept it—a superior scheme of taxation should be possible to devise.

Despite what I have said, the practice of assessing utility properties will doubtless persist for some time to come; and even a disbeliever in this practice, like myself, may therefore properly discuss what basis of assessment is the most defensible one. The subject, however, has so many ramifications that I shall here confine discussion to one aspect alone—the distinction, if any, between value for tax purposes and value for rate-making purposes. Even on this issue I shall not review the rulings of the courts. Instead, I shall give heed merely to the economic aspects of the dispute.

In order, however, to present the question in a clear-cut form, I shall ignore one situation that sometimes complicates the problem—that of relative overassessment. Public utility companies often make the point that, in a rate case, the full value of the property is the accepted criterion, whereas in a tax case, the property should be deliberately underassessed if other properties in the locality are also underassessed. This claim may be sound; but I am passing it by here, since it fails to raise the basic distinction between tax value and rate-making value. What I have in mind is a case in which a utility, without resting content to plead relative overvaluation, alleges that the full value of its property, for tax purposes, is less than the established or establishable value of the same property for rate-making purposes.

An important example of this claim has recently arisen in New Jersey. There the railroads are challenging their tax assessments in the federal courts despite their own admission that these assessments are well below rate-making values. Only one of these railroads—the Pennsylvania—is relying merely on the claim of relative overvaluation. The others are also demanding a greatly reduced assessment even if they are held taxable at full value.

The main theory which railroad counsel is advancing in these New Jersey tax cases is well known to all of you and has been discussed at length at your 1927 Conference in Toronto by Mr. George G. Tunell, tax commissioner of the Santa Fe Railroad. Briefly, the

argument runs that "value for tax purposes" is utterly different from "value for rate-making purposes" because, in the first instance, "value" really means value, whereas in the latter instance, "value" is an unfortunate misnomer for a fair rate base measured largely by estimated reproduction cost. When the Interstate Commerce Commission, for example, values the Lackawanna Railroad properties in New Jersey at \$150,000,000, it is not finding, as a fact, that these properties are actually worth that amount of money. Instead, it is deciding that, in view of their high costs and their structural condition, the properties may fairly be allowed to earn a reasonable return on \$150,000,000. But no matter what the company is allowed to do, if in fact it cannot earn such a return because of a business depression or of motor competition or for any other cause beyond its control, then the actual, commercial value of its property will not equal the rate base. And if its commercial value is low, then its tax assessment should be correspondingly low, since tax values should reflect actual values.

This is a very impressive argument, and one with the conclusions of which I am now inclined to agree. But I must confess that, until a month ago, I myself held a different opinion; and in my book on "The Valuation of Property," published early this year, I defended the thesis that public utility properties should be valued for tax purposes at their establishable values for rate-making purposes. Let me therefore first restate my earlier argument for an identification of the tax base with the rate base; and let me then explain why further study has led me to doubt the soundness of my previous position.

You will recall that those who, like Mr. Tunell, distinguish between a tax base and a rate base support their distinction on two premises; first, that rate-making value does not really mean value; second, that tax value does or should mean value. As to the first premise, I see no room for controversy. Of course rate-making value does not mean value in the approved sense of that word as used in economics, business, appraisal, and most fields of law. To be sure, the supreme court has refused to admit this fact in its dicta and has even declared, on several occasions, that there is no fundamental distinction between the "fair value" at issue in a rate case and the actual value that is the legal objective in eminent domain and in taxation. But in its decisions the court has constantly belied its own words; for it has accepted rules of evidence that cannot possibly disclose the actual value of the property in question. I therefore doubt whether any reputable economist would disagree with Mr. Tunell and others in declaring that "value for rate-making purposes" is a pseudo-value.

It is only when we come to the second premise—the assumption that tax value should, of course, mean value—that there is room for a reasonable difference of opinion. For if we concede, as we must,

that "value" is given a Pickwickian meaning under the law of rate-making, why should we assume that the same term must necessarily be given a strict interpretation under the law of taxation? In seeking an answer to this question, we must look to the general philosophy or rationale of a utility property tax. That is to say, only if we can agree upon our reasons why a utility property that is worth five million dollars should pay five times as heavy a tax as a property worth one million dollars, have we any basis for a conclusion as to the proper meaning of the term "worth" or "value" when used as the criterion of tax assessment.

Now the conventional defense of an ordinary property tax is based on the familiar doctrine of "ability to pay." Owners of the more valuable properties are supposedly able to pay a higher tax than owners of the less valuable properties. Reasoning from this assumed principle, one is forced to conclude that public utility properties should be assessed, not at their so-called physical values, but rather at their actual commercial values—at those values which alone measure the economic power of the security holders who are the beneficial owners of the properties. It follows that even if two railroad properties have the same values for rate-making purposes, but if property A has a deficient prospective earning power whereas property B has an excessive prospective earning power, the former railroad should be assessed for less than the amount of its rate base, whereas the latter railroad should be assessed at more than this amount.

For reasons that I have no time to enumerate here, I did not, and still do not, believe that the ability-to-pay doctrine supplies a valid defense of a utility property tax. A more plausible defense may perhaps be found in the argument that a public utility enterprise, no less than other enterprises, should be compelled to indemnify the community for those costs and other monetary losses imposed upon it by the existence and operation of the property. On this theory, a large railroad station should be heavily taxed, not because it is a source of wealth to its owners, but rather because its operation involves heavy governmental outlays in the form of police and fire protection, construction and maintenance of connecting highways, and so forth.

How would this very different rationale of the property tax affect the basis of assessment? In this way: that one should now seek assessments which will be correlated, as closely as feasible, with the relative burdens imposed upon the community by different utility properties. And in the absence of statistical data, I surmise that the so-called values of the properties for rate-making purposes bear a somewhat closer correlation than do the actual commercial values of these same properties. A great railroad station entails heavy governmental expenditures, not because it is valuable but because it is formidable—because it is big and complicated in a physical

sense. As long as the station is operated, it will impose these outlays on the community even though the railroad that operates it is hopelessly bankrupt. Of course, even rate-making value is a very poor index of community burdens. For it is the whole character of the property, and not merely its structural cost, that determines how much of a nuisance it is to the locality. But crude as this index is, it is perhaps even less crude than one measured by commercial value based on earning power.

I have just stated the theoretical case for an identification of the tax base with the rate base. And if time permitted, I might support this argument with two or three considerations of practical administrative expediency. But I must now present the other aspect of the controversy—and one to which I feel I gave too little weight in my recently published book.

First, let me note that the "governmental burden" theory of a utility property tax requires the revision, not merely of the basis of assessment but also of the tax rate. This revision must be made with the object, not of raising whatever revenues are required for the general support of the government, but rather of indemnifying the government for those particular outlays occasioned by the construction and operation of public utility properties. If the tax rate is made higher than enough to accomplish this sole purpose, then the resulting tax is indefensible on the theory on which I have relied to support an assessment measured by the rate base. But, so far as I am aware, state and local governments have never set their tax rates by the criterion just suggested. And unless they are able and willing to adopt this new criterion, which I suspect would often involve a material reduction in the revenues raised by the utility-property taxes, they have no solid ground on which to defend assessments based on rate-making values.

But now let me mention a very practical objection to the identification of the tax base with the rate base rather than with commercial value. Such a policy would impose relatively heavy taxes on non-prosperous utility companies and relatively light taxes on prosperous companies. With tax rates as high as they are today in many states, the result might well be, not merely to throw the less fortunate companies into bankruptcy, but even to cause the abandonment of properties that are on the margin of earning their operating expenses. Even if complete abandonment of operations did not take place, the service of the submerged companies would suffer materially through lack of corporate credit. This would be a very serious matter—so serious that the government might ultimately be compelled to take over many properties, just as the Dominion of Canada has been compelled to take over the Canadian National Railway system. And even those who, like myself, are friendly to public ownership as applied to certain types of utility service, should regret this compulsion; for public ownership can

not make its best showing if it is forced upon the country by the necessity of recapturing insolvent properties.

For the reasons just suggested, I have felt obliged to reconsider my earlier defense of a tax assessment equal to the rate base; and I now believe that the weight of the argument lies with those who insist that the commercial value of a utility enterprise, rather than so-called value for rate-making purposes, is the preferable basis of taxation. How an assessor may measure commercial value, what if any weight he should give to structural costs as indirectly bearing on this value, and how he should allocate the total value of an entire utility enterprise when the properties of the company lie outside of his jurisdiction, are questions that I have no time here to discuss. But I may say that the formidable difficulties of reaching any acceptable solution constitute a serious practical objection to the advalorem taxation of public utilities.

Since the position that I have here taken supports those railroad and utility representatives who would draw a sharp distinction between a tax base and a rate base, I think it only fair to remind these representatives that their own companies are largely to blame for their present predicament. It is the attorneys for these very companies, including Mr. Pierce Butler before he went to the supreme court, who have insisted that the high values for which they have contended in rate cases represent the actual value of the property and who have ridiculed with elaborate sarcasm those of us economists who have long declared that rate-making value does not mean value in any accurate sense of the term. It is these lawyers who have adduced the reproduction cost of the properties as the dominant measure of "true value" whenever it has seemed in the self-interest of their clients so to do. Even today, this remains the conventional position of utility counsel in rate cases. And more recently, railroad representatives have taken a similar position in reorganization cases under Section 77 of the bankruptcy act. But when it comes to tax cases, in which low rather than high valuations are desired, the companies, with a touching sense of delicacy, employ a different set of lawyers and a different set of expert witnesses who solemnly declare that value for rate-making purposes has nothing to do with true value, since true value depends solely on earning power rather than on reproduction costs.

As long as the railroad and the public utility companies persist in this attempt to take advantage of inconsistent theories of valuation—an attempt that has met with surprising success in the appellate courts—one can hardly blame tax assessors for fighting back by trying to impale them on one of the horns of a dilemma. A few years of stewing in their own juice may possibly bring utility rate-case counsel to their senses and may help them fairly to meet the real issues of rate regulation instead of bamboozling inexpert tribunals with fallacies long since discarded by impartial appraisers.

In any event, only if and when these lawyers have ceased adding to the flow of this juice, may they expect to win much public sympathy for their plausible contention that the tax base should be something quite different from the rate base.

Let me close this discussion by stating that any attempt to solve the truly critical problems of railroad and utility taxation by a mere search for a proper basis of valuation is bound to fail. The trouble lies far deeper. It lies in the doubtful validity of our whole system of property taxation as applied to regulated industries.

Again I turn to the New Jersey railroad tax situation to illustrate my point. The real grievance of these railroads is not the grievance for which they are now seeking redress in court. Their complaint that they are being assessed at more than "true value," and that they are being relatively overassessed in comparison with assessments placed upon other private property within the state, even assuming its validity, does not greatly concern me as an economist except as an aggravation of their troubles. What does concern me is the probable fact that their total taxes, including their property taxes, are far too high as compared to the total taxes imposed upon their strongest rivals—the motor carriers using the public highways. The force of this remark will be the better appreciated when one recalls that even if the taxation of motor traffic sufficed to defray the entire costs of road construction and maintenance properly chargeable to this traffic—which is reported to be far from the case in New Jersey—the railroads would still not be on a par with motor carriers unless they were entirely, or almost entirely, free from taxation. In the light of this menacing and, in my opinion, grossly unsportsmanlike discrimination against them, the question whether or not the railroads are bearing assessments disproportionate to those placed, say, on residence and on shoe-polish factories pales into insignificance.

I am aware that the particular objection which I have just urged against a railroad property tax—the loading of the dice against the railroads and in favor of the motor carriers—might possibly be removed without the abandonment of this type of tax, by a drastic increase in those taxes that can feasibly be levied against motor traffic; although I anticipate serious practical objections to any such remedy. But there would still remain another objection to the *advalorem* taxation of railroad and utility properties—an objection which, I suspect, is inherent in the very nature of that form of taxation. I refer to the fact that property taxes, when levied against utility companies at high rates, must necessarily deter these companies from improving their properties in the best interest of the public. Improvements that would otherwise be made, and that should be made because their social value exceeds their social cost, will not be constructed because they would greatly enhance the burden of taxation.

Consider the case of a railroad that is contemplating a program of electrification. An improvement of this nature, though costly, is a gain to the community if it can be made to pay its way. Moreover, so far from enhancing the burdens of government, this type of improvement will relieve these burdens through reduction of fire, smoke, and noise nuisances. Yet as long as the railroad is subject to a tax measured by the cost or value of its improved property, it must take into account the factitious increase in its annual charges that would result from the higher assessment of its electrified road. In a marginal case—and most proposals for railroad electrification are marginal cases—this tax factor may suffice to deter the railroad from making the improvement, with the result that the community will be the loser.

Similar illustrations will occur to those of you who are familiar with railroad and utility construction. For example, the generation of electricity by water power, despite the prejudiced attack that has recently been made upon it by steam-engine enthusiasts, is often more economical than steam generation from the standpoint of social cost. Yet, because a hydro plant is usually more expensive to construct than a steam plant of equal capacity, its construction may be ruled out by the purely artificial tax factor even though otherwise its higher fixed charges would be outweighed by its lower operating expenses. Here too, the community, by using the value or cost of property as a tax base, puts a premium on the erection of a type of plant—a steam plant—that will increase rather than minimize the burden of local government.

So I end as I began, by stating that, in my opinion, the best basis upon which to value utility properties for tax purposes is no basis at all.

GEORGE G. TUNELL (Illinois): I wonder if I may say a word to express my appreciation of Dr. Bonbright's reference to my Toronto paper of about ten years ago, and also to express the pleasure that it gives me that in the ten years our views have been approaching each other.

There is one other point that I would like to say a word about, that was touched upon by Dr. Bonbright, that is, the assessment and taxation of properties that no longer have substantial value. He stated that these properties might be driven out of business. His reasoning also applies to parts of properties which upon the whole may be operating successfully, but which have parts which are not paying their way.

I think possibly most of you would be surprised to learn of the examination that is now going on of branch lines and unproductive parts of systems which upon the whole are still producing net revenue in substantial quantities. I dare say that there are not less than fifteen such branches of the Santa Fe Railroad that are now

being scrutinized, and one of the principal items, if not the principal item, that is under consideration is the amount of taxes levied against those properties.

CHAIRMAN LEVIN: Thank you, sir.

The next and final talk on this morning's program is by a gentleman who has been for a number of years the chief of staff of the joint committee on U. S. internal revenue taxation.

I have great pleasure in introducing to you Mr. L. H. Parker.

THE TIME ELEMENT IN ESTATE TAX VALUATION

L. H. PARKER

Chief of Staff, Joint Committee on U. S.
Internal Revenue Taxation

The federal government and every state in the union except Nevada now impose death duties of some kind. These duties or taxes, without exception, are computed by applying a certain rate or certain graduated rates to the net value of the estate or the share of the beneficiary in such estate. Since the basis of the tax is always on value, and since value fluctuates, it is necessary to fix a time as of which the assets of an estate or the share of the beneficiary in such assets shall be valued. It is to the question as to the proper time of valuation that I shall principally address myself, although I shall take the liberty before closing to discuss briefly how time and death duties combined will probably effect the distribution of wealth.

The date, as of which property includable in the gross estate of a decedent was valued in the case of the federal estate tax, was always the date of the decedent's death until the passage of the Revenue Act of 1935. At that time, some modification was made in this rule which will be described later. The same rule of valuing property as of the date of the decedent's death is followed in the case of the death duties imposed by most of the states. In North Dakota, although the same general rule applies, the fluctuations in the value of the property six months before and six months after death must be taken into consideration in fixing the value of the property at the time of the decedent's death. In Vermont, the tax is based upon the actual market value of the property at the expiration of one year after death, probably on the theory that the estate is distributed at that time. In New Mexico, the tax is imposed on the actual value of the property at the date of appraisal. In Indiana, the date of transfer is controlling. In Maryland, the tax is imposed upon the appraised value of the estate with a right to reappraisal upon final distribution. Where there is no statutory provision in the state laws regarding the time of valuation of estates, the courts

have held that the value of the decedent's property must be determined as of the date of the decedent's death and not as of the date of probate or distribution. In the case of transfers made in contemplation of death, the value of the property at the time of the transfer is the usual basis for death taxes.

As a result of a serious decline in securities' values and in other values commencing in the fall of 1929 and continuing through the year 1932, a great deal of hardship arose on account of this rule of valuing property as of the date of the decedent's death. For example, if a man had a net estate valued at \$30,000,000 at the date of his death in July 1929, the tax was \$5,353,500 under the rates then in force, or a composite tax rate of approximately 17.84 per cent. However, suppose the net value of such estate one year after death when the tax was due, shrank to \$6,000,000. In this case, under the law then in force, the tax would remain the same, and there would only be left for distribution to the heirs, \$646,500. While the shrinkage of such amounts was not common, still there were a considerable number of cases where a very serious depreciation in the value of the estate occurred.

It was pointed out at that time that, if the tax could be paid in kind instead of in cash, no great inequity would result from a sudden decline in value between the date of death and the date of payment of the tax. For example, if a man had 30,000,000 sheep and the estate tax rate was 20%, then the tax would be 6 million sheep, and the decedent's estate would have 24 million sheep to distribute to the heirs, no matter at what time the distribution was made. The trouble comes about when property is reduced to money value and the tax is collected in money on the basis of the value of the property at the date of death. Suppose, for example, that the sheep were worth \$1.00 each at the time of the decedent's death. The value of the estate in such a case would be \$30,000,000, and the tax at the rate assumed would be \$6,000,000. Now, if the price of sheep fell to 20c. each at the date of payment of the tax, the total value of the estate would shrink to \$6,000,000, and under the tax system then in force the tax, in spite of this situation, would remain at \$6,000,000, and the estate would be entirely confiscated by the government.

In order to meet this situation, the revenue bill of 1932 as introduced in the house of representatives, contained a provision which would permit, at the election of the executor, an estate to be valued as of a date 18 months after the decedent's death. It was proposed also to value the estate as of the date of the decedent's death and determine a tentative tax thereon. The ratio of such tax to the value of the estate at the date of death was to determine the composite tax rate. This tax rate was then to be applied to the value ascertained as of a date 18 months after the date of decedent's death. In other words, this rule brought about a result very similar to the

result which would have been arrived at if payment in kind had been allowed. The provision was applicable only to the estates of decedents who had died on or after September 1, 1928, and prior to January 1, 1932. It was, therefore, entirely retroactive in character.

In the hearings on the bill held by the ways and means committee, it was pointed out that inevitable delays occur in the settlement of an estate and that it is impossible for the administrator or executor to make prompt disposition of the assets of an estate so as to protect the heirs. Numerous cases of depreciated estates were given. For example, one case was cited where the value of the estate had depreciated from \$4,500,000 to \$450,000. In this case, the tax was estimated at \$448,000, leaving only \$2,000 for the heirs.

The relief provision just described passed the house, but met with opposition in hearings held before the finance committee of the senate. Due to the fact that many states put a limit on their taxes equal to 80% of the federal estate tax of 1926, the state revenues were affected by this retroactive provision. The amendment was therefore opposed by some of the state officials on the ground it would seriously affect their finances. Moreover, it was pointed out that the rates in effect for the period covered by the amendment were low and that the commissioner had the right to give very substantial extensions of time for the payment of the tax where hardship could be shown. The relief provision was rejected by the finance committee, and the senate action was followed by the conferees, with the result that the Revenue Act of 1932 carried no relief provision for depreciated estates.

In 1935, substantial increases were made in the estate tax rates, a maximum rate of 70% being imposed. At this time relief was provided to take care of depreciated estates in a somewhat different form than that proposed in 1932. This act provides that, if the executor so elects upon the estate tax return made for the decedent, the value of the gross estate shall be found by valuing all the property includable therein on the date of the decedent's death as of a date one year after the decedent's death. Certain exceptions are made to this rule as follows:

First, property included in the gross estate, but distributed before the expiration of one year, shall be valued as of date of distribution.

Second, property included in the gross estate and sold, exchanged, or otherwise disposed of shall be valued as of the time of such sale, exchange, or other disposition.

Third, any interest which is affected by mere lapse of time, such as life estates, shall be included at the value of such interest as of date of death.

This amendment to the estate tax law was entirely prospective in character and met with no opposition from the states. It was generally accepted as being necessary to prevent entire confiscation of

estates in view of the inevitable fluctuations of value in the future and in view of the high rates imposed.

For example, under the Revenue Act of 1935, which is still in force, the tax on a \$30,000,000 net estate amounts to \$18,562,600. If this estate had that value at date of death then, without the relief provision just described, the estate would only have to depreciate by \$11,437,400, or about 38%, before the tax would completely wipe out the estate. Such a decline is not unusual and has been noted in many stocks during the last few months. The exhaustion of the estate by the tax can be prevented under existing law if the executor elects to have the estate valued as of one year after death. In the above case, the value of the net estate one year after death having fallen to \$18,562,600, the estate tax would be reduced to \$10,699,542, and there would be left for distribution to the beneficiaries the sum of \$7,863,058.

This method gives more relief than was proposed in the Revenue Bill of 1932 as passed in the house. Under that proposal, with present rates of tax, the total estate tax on the depreciated estate just mentioned would have amounted to approximately \$11,485,608, or to \$785,066 more than the present method.

The present provision appears fair and does not appear to give excessive relief in view of the high rates now in force. It gives sufficient time for the executor to come into control of the property, and he may fully protect the heirs by selling at least the liquid assets of the estate before the expiration of the one-year period, thus eliminating all uncertainty as to value. It is true that it has been contended by some that, if the government gives tax relief on depreciated estates, it should receive additional tax in cases where there is an appreciation in the value of the estate before distribution. There is considerable force to this argument, but the desired result could only be brought about by a provision that would require all estates to be valued as of one year after death, or at some other certain time. There is some doubt as to the constitutionality of such a measure since the courts seem to hold to the view that the federal estate tax is an excise, the occasion for which rests upon the transmission of property at death. It has already been noted that the present federal relief provision is optional, thus removing all constitutional difficulties.

The relief provision for depreciated estates was proposed by the finance committee of the senate and was subsequently adopted and became law. The finance committee's report has the following to say concerning this provision:

"The existing estate tax law is amended by a provision permitting the deduction of the shrinkage in value which may occur between the date of death and a date 1 year after death. If such shrinkage is allowed it is confined to the shrinkage

which can be shown to exist by taking the difference between the aggregate value of all assets on the date of death and the aggregate value of all assets 1 year after death. If assets are sold or exchanged by the executor between the date of death and 1 year after death, then the value on the date of sale or exchange shall be used in lieu of the value 1 year after death. This provision is equitable in its effects and will prevent in practically all cases the danger of complete confiscation of estates due to a sudden decline in market values. In order to give an opportunity to take advantage of this provision, the due date of the tax is extended for a period of three months, that is from 1 year to 15 months after death."

The relief provision for depreciated estates only affects the estates of decedents who have died after August 30, 1935. From that time to August of this year, it is probable that the provision has not often been used. In view of present conditions, it may be used to a considerable extent within the next year, although we hope such will not be the case. The only real objection to the provision would appear to be solely as to its possible adverse effect on the revenue. As far as the taxpayer is concerned, it prevents the confiscation of the estate and assures that a reasonable portion will be left for distribution to the heirs. It enables the executor to protect the interests of the heirs and to eliminate some of the uncertainties of valuation through actual sales. The provision may also operate to relieve the commissioner from granting such long extensions of time as have been granted in the past. Thus, it is doubtful if the provision will have a very substantial effect in reducing the revenue from this source at present.

Before concluding, I wish to take up briefly a subject which has nothing to do with the time element of valuation, but does have to do with the future effect on the size of estates brought about by high estate tax rates and the passage of time.

It is obvious, of course, that, as long as a taxpayer is living, the estate tax has no effect whatsoever on the property of the taxpayer. The estate tax falls only on the property at his death. It results that the effect of estate taxes on the size of estates and on the distribution of wealth can only be ascertained after a long period of time. The question first arises as to how often, on the average, does the property of the citizens of a country devolve.

In a report submitted to the Joint Committee on Internal Revenue Taxation in 1933, it was estimated that property devolved on the average about once in 35 years. This estimate has been substantiated by a subsequent study of the British estate tax receipts. There has been compiled the total net value of all estates in Great Britain reported to the inland revenue authorities for the 35-year period 1899 to 1933, inclusive, with the exception of insolvent

estates and estates having a net value of less than 100 pounds. We find as a result of this compilation that the total net value of the estates devolving in the 35-year period amounts to \$62,728,000,000. At about the middle of this 35-year period, namely in 1914, the eminent British economist and tax authority, Sir Josiah Stamp, estimated the national wealth of Great Britain at \$71,000,000,000. If we deduct from this \$9,000,000,000 as a reasonable estimate of the value of the property of the national and local governments and of the value of the property held by churches and charitable organizations, we will arrive at the \$62,000,000,000 which was actually found to have been transferred. Of course, we cannot check this figure from the federal statistics, because we have only had our estate tax in force for 20 years. However, it seems reasonable in view of the above to hold to the original assumption that property devolves on the average once in 35 years.

It appears plain that the effect of estate taxes in bringing about a distribution of wealth cannot be accurately known until an estate devolves twice. Thus, we need at least a 35-year record of statistics, and a longer period would be better. Therefore, a further consideration of the effect of the British estate tax for the 35-year period 1899 to 1933, inclusive, is interesting.

In the first place, we should note the maximum British rates in force during this period. From 1899 to 1906, the maximum rate was 8%; from 1907 to 1913, it was 15%; from 1914 to 1918, it was 20%; from 1919 to 1929, it was 40%; and from 1929 to 1933, it was 50%. It should be observed that high rates have been in force since 1919.

In the second place, the estates devolving in Great Britain have been classified according to size and certain facts determined as to each class.

In the case of net estates not in excess of \$50,000, it is found that estates of this size accounted for 28.0% of the total value of all estates, on the average, for the five-year period 1899 to 1903, inclusive. During the five-year period 1929 to 1933, the percentage rose to 33.6. Thus, we may conclude that the smaller estates have made a substantial gain in relative value to the total value of all estates during the last 35 years.

In the case of estates having a net value of from \$50,000 to \$100,000, the percentage to total net value of all estates has risen from 11.2 in the period 1899 to 1903 to 12.2 in the period 1929 to 1933. In this case, only a slight increase is noted.

In the same way, in the case of estates having a net value of from \$100,000 to \$200,000, the percentage of the net value of this class to the total net value of all estates has risen from 12.2 in the first five-year period to 12.8 in the last five-year period, and the gain is even smaller than in the preceding class.

In the case of estates having a net value of from \$200,000 to \$500,000, the percentage of the net value of this class to the total net value of all classes has decreased from 15.6 in the period 1899 to 1903 to 14.5 in the period 1929 to 1933. Here we find for the first time that the ratio of the net value of this class to the total net value of all classes has declined during the 35-year period under consideration.

In the case of estates having a net value of from \$500,000 to \$1,000,000, a percentage decline from 11.0 to 8.5 is again noted.

Finally, in the case of net estates having a net value of over \$1,000,000, the percentage of the net value of this class to the total net value of all classes has decreased from 22.0 to 18.4. Thus, these very large estates made up a much smaller proportion of the total value of all estates than was the case 35 years ago.

It is believed that these figures give considerable evidence that the estate tax is actually bringing about a greater distribution of wealth in Great Britain, and there is no reason to suppose that a like result will not be experienced here. This is especially true in view of our very high rates. It has already been noted that the British rates were comparatively low during the first half of the 35-year period under consideration. Undoubtedly, if high rates had been in force in Great Britain during the entire period, then a greater percentage decline in the relative value of the large estates would have been noted and also a greater increase in the relative value of the small estates. In any event, while estate taxes undoubtedly tend to bring about distribution of wealth, it is clear that they do not operate speedily in this respect, but that the lapse of a long period of time is necessary for such an effect to become apparent.

CHAIRMAN LEVIN: This, ladies and gentlemen, concludes the formal portion of this program this morning. The chair will be glad to hear any discussion of any of these interesting topics.

HARLEY L. LUTZ (New Jersey): There is just one thing I would like to suggest that Mr. Parker might have added further, and that is to tell us where we would be after we accomplished this result that is going to be ground out so very slowly by the operation of the estate tax.

MR. PARKER: Well, if you get a complete distribution of wealth, then of course you won't need any estate tax. You will never get eighty-eight and a half per cent of your revenue from the sales tax the same as some other countries do.

MR. LUTZ: That is an answer.

FRANKLIN S. EDMONDS (Pennsylvania): I would like to offer two resolutions for the consideration of the committee on resolutions:

RESOLVED, that this conference hereby request the National Tax Association to appoint a committee to consider the entire question of the taxation of capital gains.

RESOLVED, second, that the conference record its conviction that the federal tax on undistributed profits is opposed to the public interest of the country.

CHAIRMAN LEVIN: I understand, Senator, that these resolutions are to be turned over to the resolutions committee.

MR. EDMONDS: Right, sir, for consideration by the committee.

In connection with the four admirable papers we have heard this morning I want to make one slight correction, at Mr. Manning's suggestion. He referred to the fact that state corporation income taxes had been on the increase and then cited Pennsylvania at seven percent. I am very glad to report that that seven per cent, although too high, is a decrease. It was ten per cent in the preceding two years, and therefore I hope that Mr. Manning will note that fact as an addenda to his very interesting paper.

I want to say just one third thing and then I am done. I have listened to Mr. Parker's discussion with a very great deal of interest. It seems to me that this is the first sign of ameliorating conditions for the taxpayer, and personally I welcome it as a sign of tax statesmanship. I think the suggestion that was worked out in that act of 1935 is a most helpful suggestion, and those who inspired it deserve the credit and the thanks from the taxpayers themselves.

In connection with Dr. Lutz' question, if this redistribution takes place, it looks very much to me as if income from estate taxes, both for the states and the federal government, becomes very seriously decreased, and if that isn't the condition which Lord Macaulay described when he spoke of living upon the seed corn, I don't know how such a condition could come about.

IRWIN ARNOVITZ (Utah): Gentlemen, I just wanted to mention this fact. I was interested in Mr. Parker's statement about the payment of inheritance taxes in kind. May I report to this assembly, if the fact is already not known to Mr. Parker and to others in the assembly, that Utah does have just such a provision in its inheritance tax law.

May I say, however, that in the two and a half years that the law has been in force, there has not yet been any attempt by any taxpayer to make payment of inheritance taxes in kind.

May I also say that it did not occur to me that basically the purpose of the act may have been to allow for the depreciation in

estates as depreciation in the value of estates. It only occurred to us that in the event of a taxpayer desiring to make payment of inheritance taxes in kind, that it would be necessary for him to turn over to the state a given quantity of the particular commodities which the estate consisted of at the then value of the estate at the time the property was turned over to the state.

We have no provision in the law which would permit the operation of the payment of the tax in some such method as Mr. Parker suggested, namely, by delivering to the state, let us say, twenty per cent of the given commodity or the property which the estate had. If a sheep-herder owned, let us say, a herd of 20,000 sheep, and then he should die and the tax become due, there is no provision which would say that the estate should turn over to the state five per cent of the number of sheep which were owned by the decedent at the time of death.

The provision would operate, I believe, in some such fashion as this: that if the sheep had a value of \$10 per head, and the appraisalment was made on that basis, then at the time the sheep were actually delivered to the state, they would be delivered at the value that the sheep might have had at the time that the tax was fixed.

I just was interested in making that comment because, so far as I know, there is no other state which has a provision in its law for the payment of inheritance tax in kind.

CHAIRMAN LEVIN: Thank you, Mr. Arnovitz.

Will there be other discussion? If not, I think the amenities require that I turn the gavel back to the source from which I received it.

I wonder what the people down in the Judge's court are doing this morning? Do they have to wait for him to get through with the deliberations of this conference?

PRESIDENT LESER: To satisfy my friend on that point, I may say that I have received a special dispensation to devote this week to this conference.

The other day I named as chairman of the resolutions committee ex-Governor Bliss of Rhode Island on the representation that he would be here. I am now informed that he does not expect to be present, and I am therefore making a substitute appointment, Edward P. Tobie, of the same little state of Rhode Island. The state is very small, but it has some very big men in it. They tell me that seventy-five per cent of the population of Rhode Island can be reached by a loud-speaking voice from the state capitol.

I also announce as chairman of the committee on nominations, Alfred E. Holcomb. I am glad to know that he is with us.

It is also necessary under the by-laws to appoint three members of that committee outside of the ex-presidents of the association who

are present at the conference. I therefore name Farwell Knapp, of Connecticut, Carl S. Lamb, of Pennsylvania, and C. M. Brown, of Utah.

If the nominations by each delegation for membership on the resolutions committee are not in by two o'clock then the appointment will be made by me.

Is there any other business to come before this session? If not, a motion to adjourn will be entertained.

(A motion was duly made and seconded that the meeting adjourn.)

PRESIDENT LESER: The meeting is adjourned.

EIGHTH SESSION

WEDNESDAY, OCTOBER 27, 1937, 2:30 P. M.

SIMEON E. LELAND, presiding.

CHAIRMAN LELAND: Gentlemen, if you will come up here and find seats the meeting will come to order.

The first thing on the afternoon agenda is for Mr. Query to make a new set of announcements.

SECRETARY W. G. QUERY: President Leser requested me to announce at the beginning of this session that the following states have furnished names for the resolutions committee, Alabama, California, Colorado, Connecticut, District of Columbia, Illinois, Massachusetts, Minnesota, Missouri, Nebraska, New Mexico, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, and Texas. In the case of those states that have not furnished a name, he would make an appointment before the close of this session.

That is fair warning to those states that President Leser will make the appointment if a name is not handed in before the close of this session.

The following resolutions have been presented to me. I will read them and refer them immediately to the resolutions committee.

"RESOLVED, that the thirtieth annual conference on taxation sponsored by the National Tax Association is not in accord with the principles of the undistributed profits tax, both as recommended to the congress and as enacted by the congress, since the said tax is inconsistent with all the principles of taxation for which the National Tax Association has fought for thirty years, and

"BE IT FURTHER RESOLVED, that this conference recommends that the said tax be repealed."

That was introduced by Mr. Hoffman of the New York delegation.

"RESOLVED, that the conference recommend to the National Tax Association the continuance of the committee on property tax limitation and homestead exemption, and that the assignments of the committee be broadened to include the formulation of the concept of property as a subject of taxation."

The following resolution was introduced by a committee appointed by the chairman of the round table discussion on income tax administration.

“RESOLVED, that it is the sense of the group that the matter of allocating net income between the states be brought to the attention of the conference with the end in view of having appointed a committee to make a study of factors entering into the matter of allocations and of studying the feasibility of the adoption by all the states of a uniform formula for allocation of income, and of devising and recommending such a formula to the next annual conference on taxation.”

This resolution is signed by Mr. Lamb, Mr. Boice and Mr. Bradley.

I have one other resolution that will be read at the evening session.

CHAIRMAN LELAND: The general subject for discussion this afternoon is “Railroad Valuation for Taxation.” In drafting this program it has been assumed that a unit method of valuation would be followed, and the speakers have considered various problems that arise in the application of unit valuation methods to the railroad.

Among the problems that arise in this connection are, first, what is the unit? Does it include all property owned and operated, or only property owned? Is it restricted to operating property, or does it include non-operating property as well? How far shall the unit values extend and how shall they be found? Shall they be based upon stocks, bonds, capitalized earnings, and appraisals, or if any of these, in what proportions and in what degree shall they be combined?

If all three or various combinations of these elements enter into the determination of value, how shall they be weighted, or shall they be determined on the basis of averages, medians, modes, or what-not?

If the valuation is to depend upon stock and bond quotations, how many quotations shall be employed, and how long shall the period be? Shall the stock market be followed, moreover, through prosperity and depression, and if the stock market quotations cover only small volumes of securities bought and sold, how far shall these quotations be deemed to establish values on the entire capital structure? Moreover, how large must the volume of securities transferred be to establish a free or a fair competitive market for the stock?

On the other hand, if securities are neither listed nor sold, or so seldom sold as to really establish a market, how shall the value of the capital issues be ascertained? Can the administrator rely on book value? Can he approximate their worth by comparison with market value of securities of other companies? Or must valuation

be approached by way of capitalization of earnings? And if the latter attack is chosen, what earnings shall be considered, net railway operating incomes, or shall non-operating income be added?

Shall these additions include incomes from securities, joint facility incomes, incomes from property otherwise or elsewhere taxed?

Stated in another way, shall the earnings capitalized be only the net from railway operations, or be based on all income tributary to the company treasury?

But the decision as to net earnings involves definite decisions as to the extent and character of deductions. What, then, are the deductions?

Among the questions here is the allowance for depreciation and obsolescence, and if these charges are not made by the companies on their books, shall they be allowed by the tax assessors? If the property is constructed by borrowed funds, shall the companies be allowed any depreciation whatever, or shall depreciation be considered in the light or in relationship to bond amortization? And if joint facilities are involved, shall you capitalize joint facility income or expense to the owning carriers, and against those, what deductions shall be allowed?

After the net earnings are determined, how many years are you going to use and how shall each year's quotations be weighted, and after all, how reliable are these data as to past earnings, and as to the future prospects of companies?

Then after you have decided that, what about the rate of capitalization to use? Shall it be six, five, eight, fifteen, or any other percentage? Shall it be the rate which has been fixed by the federal government for recapture purposes, the average rate earned by the railroads, irrespective of interest charges on bonds? Shall it be the rate at which a comparable capital is attributed by industries similar as to risk and capacity, or shall it be the going rate of interest in the community concerned?

On the other hand, suppose there isn't any net income. Then what are you going to do? Well, you may turn to physical value, and if you turn to physical value, what standard are you going to employ? Shall it be cost, market, reproduction cost less depreciation, sunken capital, the amount necessary to reproduce the economically required facilities at that particular moment? Or shall it be the value which might be placed upon railroad property, with that same property devoted to its highest and best use in the communities through which the railroad runs? Or to alternative uses, if there are any? Or shall specific appraisals for these properties be employed, or will you in lieu of appraisals of railroad property for tax valuation purposes be willing to accept interstate commerce commission valuations? And if you do that, then what deductions or additions shall you take into account and how are you going to

bring these down to date? Can you evolve a set of index numbers that will work satisfactorily, or do you have to analyze each of these points?

After you have found what the proper unit is, how are you going to divide it among the states? Shall you use all possible factors, or shall you select a few of the factors and base your allocations on them? Shall the factors selected be given equal weight or shall a system of weights be assigned to your allocation factors, and if you weight them, how are you going to decide what the weighting shall be?

Or is allocation futile after all? Can you evolve a unitary method of valuation and then carve the values to it as ascertained for taxation by separate states, or is the alternative to that more desirable—that is, the taxation of the railroad as a unit at some rate or average set of rates and the distribution of the revenues thus received among the jurisdictions through which the railroads run?

Well, those things seem somewhat difficult. The division of revenues is somewhat difficult, but is that any less difficult than carving up the unit base and deciding what to do about that?

After you have found out what the proper valuation is for a particular state, the next problem that arises is how are you going to divide those values or those revenues among the political jurisdictions that make up that state? How are you going to share either the values of the revenues with the local units of government?

Those are problems that are in many ways similar to the allocation of unit values between the states. But as you decrease the size of the territory concerned, your problems become more complicated, the data on which you rely for answers become more and more arbitrary, and also less reliable.

If you make these assignments, shall they be made on a simple pro-rata basis? Shall you give the local areas values irrespective of the character of the lines, or the value of the property in the territories, or shall the property having a localized situs be assigned to local areas at full value, the residual values being divided by more or less arbitrary standards?

Or should the administrative authorities be allowed to classify group lines or properties according to some standard of economic importance before distributing values among local taxing districts? Or shall the railroads be taxed specific or average rates for state purposes or for the purpose of sharing revenues with local governments, or any one of a number of other alternatives?

These are some of the problems that arise in connection with this topic, and are the things about which these papers this afternoon are concerned. As I look at the program I feel not like a presiding officer but more like the lord high executioner. I simply ask the cooperation of all of the people on the program so that they shall

not waste your time in unnecessary words and that we can get right down to the heart of the discussion and conform as nearly as possible to the exigencies of the occasion so that we may go through on time.

The first paper that we are to have read this afternoon will be the paper of Mr. Mott on, "Weight to be given Physical Appraisals in Determining Unit Value Assessments for Railroads." Mr. Mott is the director of the valuation division of the California State Board of Equalization. He has had the unique experience of having been on both sides of this question, not on the three sides of the triangle as yet but only on two. He worked first for a rate-making body, determining proper rates for public utilities, and now he has transferred the experience and the knowledge that he gained there to the other side of the question, to determining the values for taxation.

It gives me great pleasure to introduce Mr. Mott.

A. G. MOTT (California): Mr. Chairman, Ladies and Gentlemen of the Conference: As I listened to Chairman Leland read off the questions which he apparently wanted answered this afternoon, I decided he would either have to abandon the twenty-minute rule or he would have to call upon some additional speakers, because I am sure that within the limits of the speakers on the program—each to twenty minutes—all his questions cannot be answered.

In my frantic effort, however, to comply with the twenty-minute rule, I propose to adhere rather rigidly to a prepared statement.

WEIGHT TO BE GIVEN PHYSICAL APPRAISALS IN DETERMINING UNIT VALUE ASSESSMENTS FOR RAILROADS

A. G. MOTT

Director, Valuation Division,
California State Board of Equalization

The assessment of railroads is of unusual importance for the reason that railroad properties constitute one of the largest single classes of physical property in the country, there having been invested in the United States in excess of twenty-five billion dollars to bring that property into existence.

A railroad system has the peculiar characteristic that its value largely exists because it is a far-flung but more or less coordinated unit of property. If a single terminal or portion of main line is permanently impaired, it adversely affects the usefulness and hence the value of the whole system as a unit. This is in sharp distinction to many other types of systems; for example, in a chain store system one of the stores might be totally demolished without greatly affecting the value of the other stores in the system.

The unit value concept is essential in determining the proper assessment of a large railroad. Furthermore, many of the general principles that are applicable in determining the unit value of railroads are also applicable in determining the unit value of other types of large far-flung but interconnected systems of property such as telephone systems.

The particular subject now under discussion, "Weight to be Given Physical Appraisals," is one of several factors which must be considered in finding the unit value.

The value of a large property is the result of a composite relationship of all facts and circumstances surrounding the property. It might be compared to a mosaic design which presents a more or less definite visual effect as a whole, but the relative importance of any single tile, of which the mosaic is made up, cannot be wholly determined by looking only at that tile. In like manner, in considering the importance of physical appraisals, or any other element of value pertaining to the unit value of a railroad system, it is necessary to review briefly the other major considerations that should enter into the final conclusion of unit value.

Although our courts, beginning with the classic *Smyth vs. Ames*¹ decision in 1898 down to the present time, have held that certain things must be taken into consideration in arriving at a conclusion of value, they have refrained from setting up any mathematical equation or announcing any formula whereby the finding of the unit value of a railroad could be reduced to a mechanical process.² On the other hand, it has become more and more apparent that value can only be determined by the proper exercise of informed judgment, and the most that can be said of physical appraisals is that they are pertinent data with which to inform and guide one's judgment.

Among the various factors that have come to be more commonly approved as basic information to consider in arriving at a sound conclusion as to the unit value of a large aggregation of property, such as a class I steam railroad system, are the following:

- a. Historical cost
- b. Reproduction cost new
- c. Depreciation
- d. Stock and bond value
- e. Earning value.

Sometimes there are other special and important factors; for example, a railroad transporting primarily a natural resource, such as a mineral deposit or stand of timber, may have its value primarily influenced by the remaining amount of that resource to be hauled.

¹ 169 U. S. 466, 42 L. Ed. 819, 18 Sup. Ct. Rep. 418.

² See note 7, *infra*.

The first three of the above named factors properly fall within the scope of this paper. However, as already indicated, it does not appear to be feasible to attempt to discuss the weight to be given these three factors without at least calling attention to the nature of the other factors and their relation to each other.

HISTORICAL COST

If there is good accounting during the construction of a railroad property, and the cost records are preserved, the historical cost is substantially the same as investment and usually is the only element of value that can be set down as a definite fact not dependent to a greater or less degree on estimate, assumption, or judgment. This certainty of fact is indeed one of the most commendable points with respect to historical cost.

Unfortunately, most of our major railroad systems had their beginnings, and much of their development took place, before the present requirements for sound investment accounting were in effect, with the result that the book records of investment cannot be depended upon to be in accordance with the facts. To a considerable extent this deficiency has been overcome by the work of the interstate commerce commission through its work on the valuation of railroads.³

³ Most of the major railroads were inventoried by the interstate commerce commission as of dates from 1915 to 1918, and these inventories were priced, except as to land, at average prevailing prices during the five-year period from 1910 to 1914. The prices during this five-year period were at a level comparable with those generally prevailing during the time the railroads had been constructed. The commission made a definite finding to this effect in the "Texas Midland Railroad Valuation Case" where it stated:

"While individual carriers have paid and would have paid, had they been constructing their properties during the five years preceding June 30, 1914, prices somewhat varying from those applied to our inventories, considered as a whole the prices employed are believed to be fair. In some cases those prices have been the result of agreement between the bureau and the carriers." (1918) 75 I. C. C. 1, 137.

This is followed with another statement reading:

"While the commission is not as well informed today as it hopes to be before the end of its work, we are prepared to state with considerable confidence that the cost of producing and equipping a railroad in most parts of this country on June 30, 1914, was a fair average for at least the 20 years preceding. There had been many changes during that period. Some prices had advanced while others had declined. The cost of labor had somewhat increased, but improved methods tended to offset this increase. On the whole, the 1914 cost was just about an average for those previous years during which the great bulk of the railroad property then in use had come into existence." 75 I. C. C. 1, 140.

Accordingly, if we take the so-called reproduction cost of those railroads valued by the interstate commerce commission in 1916 or thereabouts and add thereto the net additions and betterments since the date of valuation,

At the time of construction the cost of a property may be the best evidence of its value, if indeed it is not the only evidence of value at that time. It certainly is the measure of the amount of money that some individual or group did determine after careful consideration to be the fair equivalent of the property then acquired. Furthermore, there is one school of thought that holds, for purposes of rate regulation, that the doctrine of a fair return upon the prudent investment should be the controlling consideration.⁴ Should this doctrine become established by having the approval of the courts, the importance of the historical cost factor as an element of value for assessment purposes would be increased as it would then be one basis of control of earning power.

The historical cost of the property has some relation to the size and character of the property, and obviously size and character in turn have some bearing on value. The extent to which the historical cost should be considered as a predominant guide to value decreases as time elapses from the date of construction of the property, because of the fluctuation of price levels, changes in construction methods, and the accumulation of other important evidence of value.

REPRODUCTION COST NEW

The ordinary purpose of a reproduction cost new appraisal is to show the effect of price levels as of the time of the appraisal. In the very nature of things, the cost of reproducing a property can at best be only an estimate. The amount of the estimate for a given property can vary within wide limits, according to the assumptions that are made as to the conditions surrounding the imagined reconstruction. An ingenious valuation engineer can reach fantastic results by accurately pursuing to their logical conclusions certain theoretical and yet plausible basic assumptions.

The unreality of many estimates of reproduction cost tends to destroy confidence in this class of evidence as to value, but notwithstanding that deficiency this factor cannot be ignored. If reasonably made, it measures the cost that a competitor would usually have to incur, under current price conditions, to enter the field on a completely competitive basis. In a non-regulated enterprise this feature may make the reproduction factor quite significant as to value,

we have a remarkably sound substitute for historical cost. Attention is called to this point because it has been observed that there is a widespread failure on the part of many people generally well informed on valuation matters to appreciate that the so-called reproduction appraisals of the interstate commerce commission of two decades ago do not (even when additions and betterments are added) in fact represent a proper statement of current reproduction cost new. On the other hand, they do serve as an excellent estimate of historical cost.

⁴ Pacific Gas & Elec. Co., re rates (1922) 22 Calif. R. R. Com. 744, 757-759; Excess Income of St. Louis and O'Fallon Ry. Co. (1927) 124 I. C. C. 3, 41.

particularly as to the upper limit beyond which value cannot rise for a long period. Many rate regulatory bodies, with the evident approval of the courts,⁵ give an important weight to this factor. To the extent that this is true, the reproduction cost tends to become a measure of one limit of earning power.

Because of the importance of the reproduction cost factor in rate proceedings, valuation engineers have developed elaborate theories, the application of which tend to give relatively high values. However, it sometimes happens that these engineers often deprecate the use of these very same theories when a value for tax purposes is under consideration. If it were conceded that value for rate making is not necessarily the same as value for tax purposes — if it were conceded that the same facts may not properly be given the same weight or consideration in obtaining value for the two purposes, nevertheless the reproduction cost of the property is a fact in either case and should be recognized as such, without alteration or distortion. If a reasonable estimate of reproduction cost cannot be accepted as representing a fact, its usefulness for any purpose is lost. If it is a proper estimate of what it purports to be, it must be a proper estimate for whatever purpose it is used.

To illustrate, if the length of the railroad were important to consider in finding its value, it would clearly be absurd to use a process of measurement that would give a length of a hundred miles to be used in a rate case and a process of measurement that would give a length of ninety miles for the same property to be used in a tax case. The truth is that the road is of a certain definite length,

⁵ See *Bluefield W. W. and Improv. Co. vs. Public Service Commission* (1923), 262 U. S. 679, 67 L. Ed. 1176, 43 Sup. Ct. Rep. 675; *McCardle vs. Indianapolis Water Co.* (1926), 272 U. S. 400, 71 L. Ed. 316, 47 Sup. Ct. Rep. 144; *St. Louis & O'Fallon Ry. Co. vs. U. S.* (1929), 279 U. S. 461, 73 L. Ed. 798, 49 Sup. Ct. Rep. 384; *Los Angeles G. & E. Corp. vs. Railroad Com.* (1933), 289 U. S. 287, 77 L. Ed. 1180, 53 Sup. Ct. Rep. 637; *Northern Pac. Ry. vs. Adams County* (1932), 1 Fed. Supp. 163.

The court has held that the same principles govern in ascertaining value for tax purposes as control in confiscation cases. This is stated in the case of *Great Northern Ry. Co. vs. Weeks*, as follows:

"The full and true value of the property is the amount that the owner would be entitled to receive as just compensation upon a taking of that property by the state or the United States in the exertion of the power of eminent domain. That value is the equivalent of the property, in money paid at the time of the taking. *Olson vs. United States*, 292 U. S. 246, 254, 78 L. Ed. 1236, 1243, 54 S. Ct. 704. The principles governing the ascertainment of value for the purposes of taxation, are the same as those that control in condemnation cases, confiscation cases and generally in controversies involving the ascertainment of just compensation." *Great Northern Ry. Co. vs. Weeks* (1936), 297 U. S. 135, 139, 80 L. Ed. 532, 535, 56 Sup. Ct. Rep. 426.

Rate cases are one common class of cases that raise the issue of "confiscation" before the courts.

regardless of the purpose for which the information is to be used. Discretion and judgment properly come into play in determining the weight to be assigned to the facts to obtain the final value for a desired purpose, but discretion and judgment should not go so far as to attempt to alter the facts themselves.

One of the most useful features of the reproduction cost factor is that it gives effect to those changes in value of a property which are directly related to the changing value of the dollar as that becomes manifested in changed price levels of construction. Any attempt to arrive at a value expressed in dollars that would ignore the changing value of the dollar itself would certainly be deficient.

DEPRECIATION

The previous discussion of physical appraisals has omitted reference to depreciation. It is almost axiomatic that physical appraisals of property as if they were new, must be decreased by an amount to reflect the actual depreciated condition of the property before such physical appraisals can have any direct bearing on value. It would be going beyond the scope of this assignment to discuss the detailed processes of ascertaining depreciation — perhaps the most controversial subject in the whole field of valuation engineering. It is sufficient to say that depreciation, as that term is here used, relates to the actual decline in the usefulness of a property as compared with new, and not to the depreciation allowances recorded on the books of a company. To illustrate, one may account for the ultimate retirement of an automobile costing eight hundred dollars and lasting eight years by setting aside one hundred dollars per year. But that does not mean that seven hundred dollars would represent the depreciated cost of the automobile at the end of the first year. We all have learned that the facts of depreciation in that instance do not follow the commonly used rate of depreciation accounting.

Physical cost figures should be reduced by amounts which reflect the facts of depreciation at the time of making the valuation before they are used directly as guideposts of value.

STOCK AND BOND VALUE

The market value of outstanding securities is an element of value that cannot be ignored in determining the value of railroad property.

It is usually easy to ascertain the number of shares of stock and the par value of bonds outstanding. It is also easy to obtain the market value of the actively traded issues, leaving problems of estimates to such items as closely held issues, bank loans, or other special items. It is not so easy to select a period of average prices of securities so that the result will certainly be informative as to the value of property at any particular time. For example, nearly everyone will concede that neither the security prices of September

1929, nor those of July 1932, have very much significance in determining the value of a property today. On the other hand, many insist that the 1929 security prices had little or no relation to the value of the property they represented even in 1929. It is apparent that all of the day-to-day fluctuations in stock and bond prices cannot be explained by current changes in the value of the property. Many other forces are acting to bring about these day-to-day fluctuations. However, an average of security prices over a reasonable time, somewhat proximate to the date of valuation, is a factor not to be ignored in determining value, reflecting as it does the summation of considered opinions and speculative whims of a multitude of buyers and sellers.

EARNING VALUE

One of the best statements on value to be found anywhere is that given by Mr. Justice Brewer in the case of *Cleveland, C. C. & St. L. Ry. Co. vs. Backus*,⁶ where he said:

"The rule of property taxation is that the value of the property is the basis of taxation. It does not mean a tax upon the earnings which the property makes, nor for the privilege of using the property, but rests solely upon the value. But the value of property results from the use to which it is put and varies with the profitableness of that use, present and prospective, actual and anticipated. There is no pecuniary value outside of that which results from such use. The amount and profitable character of such use determines the value, and if property is taxed at its actual cash value it is taxed upon something which is created by the uses to which it is put."

It thus appears that the value of property primarily arises out of its ability to produce profitably useful commodities or services.

If it were possible to forecast the net earnings of a property for each of the years in the future, it would be a simple mathematical calculation to obtain the present worth of those future earnings. Such a present worth figure would be almost conclusive as to value; but, unfortunately, the future cannot be accurately foreseen. In addition to the ordinary business uncertainties as to the future, there are various unpredictable things, such as new legislation, new forms of taxation, new forms of competition, price changes, floods, droughts, and wars, that are not controllable by managements. Past and present earnings are more or less useful as a basis of estimating the future, but at best all that can be had as to the future earnings is an estimate, which, when capitalized in a proper manner, gives an estimated earning value. No justification exists for uniformly taking the earnings over any specific period of time in the past as a basis for determining earning value. Usually, but not

⁶ (1894) 154 U. S. 439, 445, 38 L. Ed. 1041, 1046, 14 Sup. Ct. Rep. 1122.

always, recent experience of the property is more indicative of its future earning power than that found at a more remote period. Much argument can be developed not only as to the accuracy of estimates of future earnings, but also as to the propriety of the rate or manner of capitalization. Accordingly, this factor of earning value is entitled to more or less weight, depending upon the confidence one has in the accuracy of the estimate. If the estimate could be known to be perfect, it probably would be entitled to nearly one hundred percent weight. But not being perfect, all other factors and information must also be weighted in with it to fortify conclusions of value.

WEIGHTING OF FACTORS

Having briefly reviewed the nature of the major factors that are more commonly used, we reach the question of how these factors shall be combined to obtain value.

After several years of serious thought on this question, the writer has come to the firm opinion that there is no specific formula that can be generally applied to different properties and reach a finding of value that will do equal justice to all of them.⁷ Furthermore, a formula that would result in a proper statement of value for a certain property for one year might be seriously in error when applied to the same property another year. Under some circumstances (for example, when a property is first constructed), physical appraisals can properly be given almost one hundred percent weight. Under other circumstances (for example, when earnings are well assured at a stabilized level for a long period in the future) the capitalized earning figure may be almost fully conclusive as to value. Under still other circumstances (for example, when security markets are generally on a fairly stable basis, but the future of the particular property is subject to gross uncertainties), the stock and bond value may be the most important indication of value on the theory that the judgment of many is more likely to be sound than the judgment of one.

The nearest approach to a formula worthy of general application appears to be the statement that the various factors of value set limits outside of which true value will not be found, and even that statement is subject to some qualification. The amounts that would have been ascertained for the various major factors of value for certain properties in 1929 would each have been in excess of what we all know now to have been true value at that time—a conclusion due to the superior quality of our hindsight over our foresight.

⁷ See *Minnesota Rate Cases* (1912), 230 U. S. 352, 434, 57 L. Ed. 1511, 1556, 33 Sup. Ct. Rep. 729, wherein the court stated:

"The ascertainment of that value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment, having its basis in a proper consideration of all relevant facts."

Thinking of the more commonly encountered situation now surrounding the large railroad systems of the country, it appears that physical appraisals should usually be given a relatively minor weight in determining unit value, and only in rare instances should this factor be given the importance of predominant weight. But even if the weight of this factor is usually small, physical appraisals are of extreme importance for other purposes. As a matter of fact, we in California consider them as one of the most important bases for apportionment of value as between states or as between taxing jurisdictions within the state.

CONCLUSION

In conclusion, let it be recognized that judgment, or, if you please, informed judgment, arrived at after skilled and careful consideration of all relevant data, facts, and relationships, is the base upon which the finding as to unit value of any complex property must rest. Let us not expect the impossible by assuming that a simple or even involved formula can be written and handed to a group of calculating machine operators to grind out satisfactory final answers as to value.

What is the weight to be given physical appraisals in determining unit value assessments for railroads? The answer is, no uniform weight can properly be used, but rather, the weight to be given must be separately determined for each valuation undertaken. But notwithstanding the fact that physical appraisals usually exert a minor influence in determining the over-all value, such appraisals are indispensable to any well-rounded plan for the valuation of large properties.

CHAIRMAN LELAND: I am glad to observe the fact that Mr. Mott has still to his credit two minutes and thirty-eight seconds. We will allow him to add that on to any retorts he cares to make to the discussers.

The next paper is one that has been prepared by Mr. C. M. Chapman, in charge of the public utility taxation department of the Wisconsin Tax Commission. Unfortunately, Mr. Chapman is not able to be here but has asked that his paper be read by his old friend and college mate, Mr. George Mitchell, the statistician of the Illinois Tax Commission. I assure you I didn't have anything to do with that. That is not a put-up job between George and me.

This paper is "The Use of Railway Statistics and Accounts in Determining Taxable Valuations."

Mr. Mitchell, it is a pleasure to present you in lieu of Mr. Chapman.

USE OF RAILWAY STATISTICS AND ACCOUNTS IN
DETERMINING TAXABLE VALUATIONS

C. M. CHAPMAN

Public Utility Taxation Department,
Wisconsin Tax Commission

In order to simplify discussion of this subject we intend to discuss only those statistics to be used in determining system unit valuations, together with the apportionment of unit valuations to the state making the assessment. We shall refrain from any discussion of the apportionment of the assessment to the several municipalities in which the railroad may operate, inasmuch as such a problem is not common to all states using the ad valorem basis of taxation.

In Wisconsin, for instance, the assessed value of railroad property is taxed at an average state rate and all railroad taxes are paid into the state treasury. With the exception of a relatively small amount of taxes on certain terminal properties in lakeport cities, all railroad taxes are used for statewide purposes and are not apportioned to the various municipalities. The tax rate is an equalized rate determined by dividing the total taxes on all locally assessed property in the prior year by the full market value of that property as determined by the tax commission. In other words, all equalization of railroad taxes with other property taxes is effected by using an equalized tax rate rather than by equalizing railroad assessments with the local assessment of real and personal property.

Our statutes require that all property be assessed at its "full market value." Other states may have slightly different terminology but, in general, the intent is the same. In other words, the property is to be assessed at a value which would result from a transaction between a willing seller and a willing buyer dealing at arm's length. Inasmuch as railroad property seldom is sold, the assessing official must seek after those facts which tends to indicate what the market value would be if it were sold under normal circumstances. There are three generally accepted indices of valuation of railroad property for assessment purposes, i. e.:

1. Market value of stocks and bonds
2. Capitalized net operating income
3. Cost of reproduction less depreciation.

In addition, the history of the company, its past record of earnings, the territory served, the prospects for the future, present economic trends, the general condition of the railroad industry, and all other pertinent facts should be laid before the assessing officials who, in their judgment, must test any formula by such supporting data.

Any formula designed to determine taxable value should be considered only as indicative of value and not as conclusive thereof. Statutes relating to ad valorem assessments generally provide that the taxing officials "according to their best knowledge and judgment shall ascertain and determine" such valuations. In other words, no mathematical formula can be substituted for sound, honest and mature judgment. All possible statistical data relating to the company in question should be brought before the assessing body for careful consideration. Railroad methods of operations are not uniform. Neither are methods of financing. Traffic conditions, territory served, and a host of other differences make it impossible to devise any set formula for obtaining taxable values of railroad property without the exercise of judgment or common sense. A consistent use of a fixed formula would likely result in discrimination as between railroads. If the problem of determining taxable values could be solved by the application of standard formulae, the whole matter could be left in the hands of a statistical clerk who would apply the magic formulae to accepted facts and, presto, out would come the desired result.

The time limit prescribed for this paper will not permit us to quote from numerous court decisions, some of them recent ones, which indicate that even our courts occasionally succumb to the wiles of a magic formula. But in the main, the courts have taken the statistical data as indices only and have stated that the assessing officials in the exercise of their judgment have or have not given full consideration to such data. It is not logical, for instance, to state dogmatically without modification or amplification that the value of a railroad for purposes of taxation is exactly the mathematical average of capitalized net operating income and market value of stocks and bonds, or any other combination of indices of value. We repeat, therefore, that statistical formulae can not be substituted for judgment in determining taxable values, but statistical data honestly compiled can be of invaluable aid in assisting in the formation of sound judgment as to taxable value.

MARKET VALUE OF STOCKS AND BONDS

Probably this index of value more than others had had the sanction of our courts. In one leading case, Justice Miller of the United States Supreme Court said:

"It is therefore obvious that, when you have ascertained the current cash value of the whole funded debt, and the current cash value of the entire number of shares, you have by the action of those who above all others can best estimate it, ascertained the true cash value of the road, all its property, its capital stock and its franchises: for these are all represented by the value of its bonded debt and of the shares of its capital stock." (92 U. S. 575, 605)

We have compiled statistics on market value of railroad securities ever since our ad valorem tax went into effect, about thirty-four years ago. For many years we kept a daily record of exchange transactions for both stocks and bonds. About four years ago we substituted weekly summaries of such transactions as reported in the *Commercial and Financial Chronicle*, thus saving considerable clerical work and with practically the same results. At the end of the year we find the total number of transactions and the total consideration therefor and compile the average unit price for each security for the year. This average unit price is applied to the total issue outstanding in the hands of the public. The average prices for five years are recorded on cards and the five-year average unit prices are applied to the total issue outstanding at the close of the year nearest the date of assessment. We then compile the total capital structure and the five-year and single-year market values of these securities.

Some statisticians apply average unit market values for a given year to the securities outstanding at the end of that year to determine the market value of securities for that year. The same procedure is followed for each of the years to be used in the average and then an average market value is determined for the period. This method is satisfactory providing that there is no change in the par value of securities over the period. If, however, there is a variation in the capital structure this method may lead to faulty conclusions. Primarily, the only reason for using the stock and bond method is to measure the worth of the operating assets at a date nearest to the effective date of assessment. It should be readily apparent, therefore, that the average unit values for each of the securities should be applied to the par value of securities outstanding at a time nearest to that date. If this is not done, the result may be grossly overstated or understated.

Despite the often repeated faith in the stock and bond formula for ascertaining taxable values, experience has taught us that the method is far from infallible. The market value of securities does not in fact solely represent the investor's composite conception of the worth of the railroad property. In the case of railroad bonds the interest rate plays an important point in the price level. We know of certain railroad bonds having a long maturity in which the interest is guaranteed by another railroad. Insurance companies have purchased large blocks of these bonds primarily for the guaranteed income over a period of years, and the market value at a given time in effect represents the present value of the annual guaranteed interest over the entire life of the bonds. The price originally paid for the bonds has actually been written off the books of the purchasing company. To treat the market value of these bonds as representative of the physical property is tantamount to importing value from the controlling railroad and placing it in

the property being assessed. A 3½% first mortgage bond may represent exactly the same investment in railroad property as a 5½% or 6% first mortgage bond, yet under normal circumstances the bonds will not have the same market value. Maturity dates also have an important bearing on market value trends.

It is true that the general trend of the market reflects more or less the state of the railroad industry. But one must bear in mind that there is a speculative interest in the security market as well as an investor's interest. When the speculation fever is rampant it runs far ahead of sound investment judgment. Conversely, when the market gets panicky, due to war scares, political moves, or other forces which may or may not actually affect real values, then the security values plunge far below the real worth of the property underlying the securities. We have in mind the stock of one large Wisconsin corporation which during the depression was selling below its worth as measured solely by its liquid assets. It had sufficient cash on hand to acquire practically all of its outstanding capital stock at the prevailing market and still have enough left for working capital.

The security exchange market is a sensitive instrument. A note of optimism in one branch of industry buoys up the securities in other branches wholly unrelated, and if something happens to adversely affect a certain industry, its securities are prone to plunge downward and carry other security values with it.

Knowing the vagaries of the security market it is therefore not sound in our judgment to pin absolute faith in the stock and bond formula as a definite measure of property taxation. Rather it would be wiser to treat the method as one index of value, to be tested and weighed against other methods and general economic trends, all of which must finally be measured by the honest judgment of the assessing officials.

DEDUCTIONS FOR NON-OPERATING ASSETS

If we start out with the assumption that the market value of stocks and bonds measures the value of the assets of the railroad company, then we must scan the balance sheet to ascertain what assets the company has other than the operating property subject to assessment. The current assets, such as cash, accounts receivable and materials and supplies, and the current liabilities, such as loans and bills payable, traffic and car service balances payable, and audited accounts and wages payable, may be safely considered as necessary adjuncts of the main business of operating the railroad company. In other words, every going concern must have a sufficient amount of working capital at all times to effectively carry on its business. Consequently, nothing should be deducted from or added to the market value of securities for these current assets and current liabilities.

But under the heading "Investment" on the asset side of the balance sheet, there appear such items as "miscellaneous physical property," "investments in affiliated companies" and "other investments." Many of these items can be treated as non-operating assets not necessary to the operation of the transportation business, and to the extent that the value of these assets influences the investing public in its appraisal of the outstanding securities, to that extent such influence should be eliminated from the market value of stocks and bonds. The perplexing problem lies in the determination of that influence.

If the non-operating assets consist of securities that have a known market value, no problem exists. However, it should be clearly established that the ownership of such securities is solely for investment purposes. If a railroad company acquires the securities of another company in order to secure favorable transportation contracts or terminal facilities, then the deduction of the market value of such securities becomes rather questionable. It is therefore very important that the assessing officials be thoroughly conversant with the inter-company relations of the railroad and the companies whose securities it holds.

Some railroad companies submit a schedule of deductible assets based on the cost or book value of these assets. Such a contention is indefensible, proof of which is the ratio of the market value of the company's securities and the depreciated book value of all of its assets.

Another very common contention is that the assessed value of locally assessed lands should be deducted from the market value of stocks and bonds. If these lands are located in a state where the practice is to assess at a percentage of full value, the railroad company raises the assessed value of these lands to one hundred per cent in claiming the deductions. On its face this procedure appears reasonable. But did the investing public consider locally assessed values of these lands in its appraisal of the market value of the stocks and bonds? Are the lands in question included in the railroad property covered by the several bond indentures? Primarily, the investing public is interested in a reasonable return on its investment and an assurance of repayment of the principal. Income from non-operating assets therefore is rather important. It is well known that some railroad companies own considerable idle non-operating land from which practically no income is derived. Because of the continual burden of local taxation on such properties, it is conceivable that the investing public may look upon these lands as a liability rather than as an asset, and to that extent the ownership of such property acts as a drag on the market value of outstanding securities.

If the lands in question have valuable mineral or timber resources, such facts should be given consideration in the deduction for non-operating assets. Many railroad companies have wholly-owned subsidiary coal companies, which furnish the railroad company with most of its fuel needs. Usually the capital stock of the subsidiary is a nominal amount and the railroad company, disregarding the separate corporate entity, will claim a deduction measured by the value of the coal deposits and other assets of the subsidiary. Two questions arise in the consideration of the deductibility of such an item: first, is the ownership of the coal corporation reasonably necessary to the operation of the railroad business? If so, then any deduction is questionable. Second, is the investing public fully possessed with facts necessary to weigh the influence of this ownership on the securities of the railroad company?

We have endeavored to point out a few of the problems that arise in attempting to measure the influence of non-operating assets on the market value of stocks and bonds. The problem is perplexing and is so susceptible to human judgment that any solution thereof must be considered a rough approximation and not a definite conclusion.

CAPITALIZATION OF NET OPERATING INCOME

This theory of determining the market value of a property is what is commonly called the "going concern" method. It is based on these assumptions:

1. The fundamental test of value of a property is its ability to produce income in the future.
2. Future earnings can reasonably be measured by past earnings.

Neither one of these assumptions can be accepted without considerable reservations. We have throughout the country many railroad properties operating consistently with annual losses. No one would honestly contend that such properties have no taxable value, or have a negative value. At least the property would have a junk value which must be recognized, and there are instances which would warrant the assumption that if a reorganization were effected and non-productive branches eliminated, the road could be brought back as an income-producing property.

For a road that is a going concern, the earnings test of value undoubtedly has considerable merit. The only way we have of forecasting future earnings is by studying past history and present economic trends. A sufficient number of years should be taken into consideration to be representative. It is customary in railroad taxation to use a five-year period, but even that period may not be representative. Five years consisting of three years of extreme

depression conditions and one year of noticeable but slight improvement and one year of definitely on the up trend, hardly could be treated as a normal period to use as a forecast of the future. The converse situation would obtain if there was a predominance of boom years in the period under review. In a recent opinion by the tax commission of the state of Washington we find the following language:

"Like many other enterprises, railroads have their good and bad periods. In a general way their earnings seem to follow the business cycles of the nation. Therefore, to get a fair cross-section of the earning power of a railroad as indicated by its past operations, it would appear that for valuation purposes the net earnings should be as nearly as possible averaged over a period covering a complete business cycle."

There is considerable merit in the above statement although, as a practical measure, a business cycle of fifteen or more years would be unwieldy. Yet sufficient data should be compiled relating to business trends so that even though a three-or five-year period is actually used as a test, the assessing officials can modify the results in their judgment as to the reliability of the trend used in the computation.

The same principles governing the length of period to be used are applicable to the stock and bond method of valuation as have been discussed in connection with the capitalized net operating income method. In other words, the period used should be representative, whether it be a single year, three-year average, five-year average, or a longer period.

The rate of capitalization to be used generally will be based on the prevailing rate of interest necessary to attract capital into the industry. A study of the capital structure, with special reference to recently refinanced issues should be a valuable guide as to the rate to be used. The rate most frequently used is six per cent, but it may be a too high or too low rate for the company under consideration, depending on the type of company and, as stated above, on the cost of borrowing money. In a recent tax decision involving a utility assessment the Wisconsin Supreme Court said:

"If it is proper to apply a rate of six per cent in normal times, it seems to us that the use of a lower rate for valuation purposes is entirely proper in times of financial depression. While it may seem anomalous to use the lower rate in times of depression with a resultant higher valuation of the property, a closer analysis indicates its fairness. Property of substantially the same value will earn a higher rate of return in good times and a lower rate in bad times. Capitalization at current rates of return will reflect the essentially equal value

of the property during these years, and this is substantially sound, other factors being equal. The evidence sustains the conclusion of the trial court as to the proper rate of capitalization. At least it can not be said that six per cent is too low, and we seriously question whether a rate of five per cent could be disturbed. (*Wisconsin Gas & Electric Co. vs. Tax Commission*, 221 Wis. 487.)

In testing market value by the capitalized net income method it is well to investigate management policies, accounting procedure, etc., of the railroad company. Maintenance policies of various railroads vary widely. Some railroads are far more conservative in their expenditures that affect operating expense, etc., than are other roads in the same class. Naturally such conditions should be understood if discriminations as between railroads is to be eliminated.

COST OF REPRODUCTION LESS DEPRECIATION

Although this test of value has not been looked upon with great favor by our courts, yet after all we are dealing with ad valorem taxation of operating railroad physical property, and to completely ignore the physical property itself does not appear quite logical. Every state undoubtedly must assess some railroad property for which market value of securities is not available, and capitalized income is either not possible, due to operating losses, or is negligible compared with the preponderance of physical property devoted to the business. Manifestly the assessing officials must determine the assessed value to some extent by evaluating the physical property.

For the major railroads it is possible to secure interstate commerce commission cost of reproduction figures brought up to date, and at least a rough approximation as to the depreciated condition thereof. By studying the pricing used in the original inventory and subsequent improvements and comparing the same with current price indices it is possible to approximate whether the interstate commerce commission appraisals is too high or too low as compared with current prices.

In considering the question of adequate accrued depreciation, it is important to take into consideration also the maintenance policy of the company. Efficient operation of the road requires adequate maintenance, and at least to a modified extent the maintenance will tend to arrest depreciation.

ALLOCATION FACTORS

After system unit values have been determined it becomes necessary in the case of inter-state roads to apportion such values to the state making the assessment. These factors should measure distri-

bution of property as between states, modified by the business activity of the property in the respective states. Some statisticians favor factors of allocation based on business activity only. Such a procedure would be favorable to some railroads and would penalize others. It is well to use enough factors to avoid extremes in apportionment percentages. In Wisconsin we use the following factors:

1. Gross operating revenues
2. Net operating income
3. Mileage all track
4. Car and locomotive mileage
5. Revenue traffic units
6. Physical property.

Practically all of these factors are standard practice and need not be discussed. Many authorities frown on the net operating income factor for the reason that the expense apportionment as between states is wholly arbitrary. We use it for comparative purposes as somewhat of an indication of the productivity of the railroad business in our state. Some states advocate its use with great vigor. The chief criticism of the use of this factor lies in the fact that in some states it would import a negative amount of property to that state. Such a result appears to condemn it as an apportionment factor to be relied on to determine a fair apportionment of property.

STATISTICAL INFORMATION

In addition to statistical data relating to the three general tests for determining taxable value, previously discussed, and data for apportionment, every possible type of information relating to the railroad property and its operation should be assembled and presented to the assessing officials to assist them in a thorough understanding of the problem. All tables should be carefully compiled in a logical and lucid manner. The titles of the tables should be studiously worded to convey the general meaning and purpose of the data. Care should be exercised to present facts and not conclusions. This supplementary information might include the following for a period of years prior to the year of assessment:

1. Operating revenues, operating expenses, net operating income, and operating ratios.
2. Dividend and bond interest records.
3. Net income.
4. Total taxes paid by the company, taxes paid in the state in question and percentage of total taxes paid in the state to total taxes.
5. Ratio of the assessment to gross revenue derived from the state.

6. Ratio of assessment to I. C. C. valuation depreciated.
7. Assessment per mile of road operated and per mile of all track operated.
8. Percentage of state taxes to state gross operating revenue.

In our state, after the assessment data has been compiled it is typewritten and assembled in books for the use of the tax commissioners. As soon as the assessment has been determined, each company receives a copy of the assessment data relating to its own operations upon application therefor. This procedure, of course, lays the data open to attack at the time of hearing on the assessment, but after all that is not so serious for, if there are any inaccuracies in the statistical data, they will come to light and can be corrected. It is mutually advantageous to the state and to the taxpayer that the statistics considered by the assessing officials be accurate. Finally, if the assessment data will not stand up under cross examination, it is hardly worthy of the name.

Several years ago a representative of one of the utilities appearing before the Wisconsin Tax Commission in protest against an assessment facetiously referred to our assessment data as "Heinz's Fifty-seven Varieties." We doubt whether the remark was intended to be complimentary. But, as a matter of fact, he was paying tribute to the real purpose of the statistical information, assembled for the use of the assessing officials in the exercise of sound judgment to the problem before them.

CHAIRMAN LELAND: Well, we have now determined the unit value. The last two speakers have included all the elements that are conceivable and we have now valued the railroads. The next two speakers will proceed to divide them up.

The next speaker is Mr. William T. Faricy, general solicitor, Chicago & Northwestern Railway Company, Chicago. I always wondered what that "T" was for until this noon. I found out. It is orange pekoe.

Mr. Faricy will talk on the "Importation of Taxable Values Under Unit Rule Formulae."

IMPORTATION OF VALUES THROUGH THE USE OF UNIT RULE FORMULAE

WILLIAM T. FARICY

General Solicitor,
Chicago & Northwestern Railway Company

The above subject presupposes that system value has been fixed. The question then arises what factors fairly may be used in the case of an interstate railroad to apportion to each state its proper share of the system value? Conversely, what factors operate to

import into one state value which properly belongs in another state? If value is so imported and that which is added in one state is not subtracted in another, the result will be, and in practice often is, to produce an aggregate of assessments which is greater than the system value used as a starting point. There is a widespread practice of using one or more appropriate factors in combination with one or more inappropriate factors in an effort to mitigate the error of the latter by assimilating a part of the virtue of the former. In the case of a given railroad, such an effort by the taxing authorities of eight or ten different states, each putting in as the improper factors to average with the proper ones those from the list which are most favorable to the particular state, leads to an aggregate overassessment of the railroad. This is a result which naturally the railroads want to avoid and which is not intended by the assessing bodies. What, then, are the factors most commonly in use and what are the virtues or vices of each? Eight factors are most frequently encountered in various groupings. These eight are as follows:

1. Traffic units.
2. Gross earnings.
3. Car and locomotive miles.
4. Transportation train miles.
5. Miles of road operated.
6. Miles of all tracks operated.
7. I. C. C. appraisal,—that is to say, the ratio which I. C. C. appraisal in one state bears to the total I. C. C. appraisal for the particular road.
8. Net earnings.

Before proceeding to a consideration of each of these factors in detail, let us have in mind that the courts and taxing bodies generally recognize that actual value in the case of a railroad arises from use and the profitableness of use. Without use a railroad is simply a long, narrow strip of land with tracks and ties on it, worth very little as salvage. Without such use as produces profit, it is unattractive from a purchase or investment standpoint and it is that standpoint which gives commercial value. Nobody buys a railroad for sentimental reasons. Railroads and the fractional parts represented by their stock and bonds are bought and sold only for what they are thought to be commercially worth, and that worth is directly dependent on use and the ability to translate use into some net profit. With these observations in mind we turn to the list of the eight allocating factors named a moment ago.

The first of these is traffic units. This factor consists of tons one mile of freight plus passengers one mile. When a ton of freight moves one mile, that is a traffic unit. When one revenue passenger

travels one mile, that is likewise a traffic unit. Add all the ton miles of freight and all the passenger miles and you have the total traffic units. Railroad records are so kept that these units can be apportioned exactly according to state lines. The factor of traffic units has the following qualities:

- (a) It is accurate and actual.
- (b) It is simple and accessible.
- (c) Its units have the same characteristics in every state, that is to say, a ton is a ton, a passenger is a passenger, and a mile is a mile in every state. There is no variation in the characteristics here stated.
- (d) It is an exact measure by weight of the volume of traffic transported in each state regardless of the nature of commodities or the question of intrastate and interstate traffic.

In the possession of all four of these particular characteristics, it stands alone among all of the allocating factors available, and deserves, and has received, increasing recognition as a fair and just factor. However, it does not fully reflect the relative earning power of the traffic so transported, and therefore appropriately may be linked with an earnings unit. That brings us to the second factor.

Gross earnings, the second factor, reflects the earnings arising from the use of the property. If the assignment of earnings from interstate traffic could be made from the records upon an accurate and admittedly equitable basis, it would be the most nearly unassailable of the allocating factors available for our use. It is, however, subject to these conditions:

- (1) Freight rate levels in the different states vary.
- (2) Freight rate structures are not adopted as to interstate traffic with any recognition of state lines.
- (3) Through billing of freight, rebilling, reshipping, reconsigning, absorptions of switching charges to meet competition, and various other conditions incident to freight traffic, present outstanding difficulties which prevent exact mathematical accuracy in computing the amount of interstate freight revenues which equitably may be assigned to each state.

Considering all of these circumstances, those charged with the duty of allocation have adopted the mileage prorate of all interstate revenue as complying with three of the four requirements recommended by previous committees of your association, that is to say, it is simple, actual (i. e., it rests upon an actual base), and the data necessary for its determination are readily accessible. Hence, it has received almost unanimous approval for this purpose. Repeated tests show that this factor has the least variation from factor No. 1 (traffic units) of any of the factors 2 to 8 which we are discussing.

The fact that these units of measurement, traffic units and gross revenues, come out somewhere in the same neighborhood, to my mind commends them for use. To the extent that they vary somewhat as between themselves, one acts as a check on the other. The fact that the traffic units factor does not fully reflect variations in the revenue characteristics of the traffic is offset by the fact that the gross revenue factor does so, and, conversely, the fact that gross revenues on a mileage prorate do not always fully reflect the effect of transit privileges and absorptions is offset, in part at least, by the mathematical accuracy of traffic units in this respect. The two factors complement each other admirably.

The third factor is car and locomotive miles. This is a factor which seems to be growing in favor. Its popularity is due largely to the ease with which it is obtained and the first blush plausibility of its use. Its principal defect is in the assumption that a freight car costing \$2,000 is equal as an allocating unit to a locomotive which costs anywhere from \$60,000 to \$100,000, or to a passenger coach costing anywhere from \$20,000 to \$40,000. If the proportion of each of these differing factors were the same in all states, i. e., if every freight train in all the states consisted of one locomotive and forty cars and every passenger train consisted of one locomotive and seven cars, and also, if there were one passenger train to every two freight trains in every state, the effect of the inequities in the characteristics of the units would be neutralized by the uniformity of the trains in service in each of the states. However, such conditions do not exist and the defect in the unit remains. In fact, in one aspect this factor exerts rather a perverse effect. We all know that the thing that makes a railroad valuable is the density of traffic. If you take two states, each with an equal number of traffic units, and in one such state more car and locomotive miles are consumed to move the same number of traffic units, the use of car and locomotive miles as an additional allocating factor will assign more value to that state, when in fact the operation is less efficient. The greater value should lie in the state in which the more efficient movement of the same number of traffic units with a lesser number of car and locomotive miles takes place. Yet in spite of this perverse effect, the factor "car and locomotive miles" comes closer to the result produced by the good factors of traffic units and gross revenues than do any other factors, as we shall see.

We take up next the fourth factor, transportation train miles. This factor was used to a considerable extent some forty years ago. It gave satisfactory results until the development of the heavy freight locomotives and the consequent increase in the weight of trains in different sections of a single line, or in different states, and also the greater spread between the long freight train and the passenger train of a length ranging from six to ten cars. About

twenty years ago it began to become apparent that this factor produced some inequitable results. Its defect came into bold relief when an average train mile, although a unit of service, might carry 200 tons of revenue freight in one state and 800 tons in another state. This factor lacks the quality of being a unit of equal value in each state and it therefore becomes like a rule of eight inches in one state and sixteen inches in another, but used in both as twelve inches. This disqualifies it as an accurate measure of value.

We have thus far considered the factors commonly known as use factors, two of which, (1) traffic units and (2) gross earnings, are good and two of which, (3) car and locomotive miles and (4) train miles, are not so good because of the varying characteristics in the different states. We now come to the factors which represent the property itself, which are: (5) miles of road operated, (6) miles of all tracks operated, and (7) I. C. C. appraisal.

Factor No. 5 is miles of road operated. In the early days when the railroads of the West were single track lines the custom of using miles of road operated as a factor of measurement for a great variety of statistical comparisons was quite common and on the whole fairly satisfactory. As the country developed and large cities grew, with conspicuous industrial development, the characteristics of the railroads in some states became quite different from those in other states and the mile of road operated as a factor was less and less appropriate because of the changes made. As a result of these circumstances, the factor miles of road operated has fallen from favor. A committee of your association has heretofore condemned it for general use and the things which made it bad at the time of such condemnation make it worse now. At the present time a mile of road in one state may bear only slight resemblance to a mile of road in another state. To illustrate, the C. & N. W. line across Iowa and Illinois carrying the transcontinental trains between Chicago and Omaha is double track and of heavy rail construction throughout; has automatic train control; embodies the best known devices for safety and convenience of traffic, and is a line of heavy traffic density. These conditions do not exist as to its lines in Nebraska, South Dakota, Michigan, Wyoming, Minnesota or southern Illinois. The earning power per mile of road and traffic units vary in all the states traversed by the C. & N. W. The impropriety of using miles of road as a sole allocating factor was recognized by the United States Supreme Court in the case of *Wallace v. Hines*, 253 U. S. 66. There such a statutory basis of allocation was held so arbitrary as to take the property of the Northern Pacific Railroad without due process of law. The case involved an assessment by the state of North Dakota and is a perfect example of importation of value through too rigid adherence to miles of road as a sole allocating factor. Fifteen years later, in the case of *Rowley*

v. Chicago and North Western Ry. Co., 293 U. S. 102, which involved the C. & N. W.'s assessment in Wyoming, the United States Supreme Court adhered to its finding in the Northern Pacific's North Dakota case that miles of road if used alone would constitute arbitrary action, but refused to extend that doctrine to the use of the erring factor when combined with a number of other factors. The court held that when the factor "miles of road operated" was averaged with the use factors of traffic units, car miles plus locomotive miles and a composite of gross and net earnings, the result so diluted the original vice of the factor that the result did not denote arbitrary action. The law of the land recognizes the propriety of mixing up the allocating factors, good, bad and indifferent (just so you use enough of them), without the result being arbitrary action. Such, for instance, was the method approved, inferentially at least, in *Great Northern Ry. Co. v. Weeks*, 297 U. S. 135, with which you are all familiar. But a body of the kind which I have the honor of addressing today is concerned, not with the question how far an assessing body may go without trespassing on the domain of arbitrary action, but what factors within the permissible range of discretion show the fairest results and are the most equitable. Measured by that test, I have no hesitancy in saying that except in the case of a railroad having a homogeneity of operation and characteristics in its several states, the factor "miles of road operated" is one of the chief offenders in importing from the populous states into the sparsely settled states a very substantial part of system value.

The sixth factor is "miles of all tracks operated." This contains most of the defects which are inherent in the factor miles of road operated but in a lesser degree. However, the fact that this divergence from an accurate measure is less in the case of all track miles than in miles of road does not permit its classification with such accurate factors as traffic units and gross revenues. To test the performance of the factor "all track miles" as compared, on the one hand, with the accurate factors "traffic units" and "gross revenues," and with the inaccurate factor "miles of road operated," our able statistician, Mr. C. F. Balch, to whom I am indebted for most of the data going into this paper, figured out how much variation there was on the C. & N. W. in 1936 in the service and revenue units per mile of road and per mile of all track. Operating revenues per mile of road varied all the way from approximately \$2,000 per mile in North Dakota to \$32,000 per mile in Illinois. Traffic units per mile of road varied from 173,000 in North Dakota to 2,500,000 in Illinois. Let us now relate the maximum variation, that is the difference between the highest state and the lowest state, to the average for the entire line. To make clearer what I am now discussing, let us assume an average of \$10,000 of

gross revenues per mile of line. If the variation in gross revenues between the highest and lowest state, figured per mile of road, were \$20,000, we would call that ratio 200% of the \$10,000 average. A figure of 100% would find the factors in agreement. The actual figures on the Chicago and North Western for 1936 showed a ratio of maximum variation to mean or average of 277% in operating revenues per mile of road and 276% in traffic units per mile of road. If we substitute for miles of road the factor all track miles, those percentage ratios of maximum variation to mean or average become 152% in gross revenues per mile of all track and 150% in traffic units per mile of all track. Gross revenues per mile of all track varied from \$1,712 in North Dakota to \$12,262 in Illinois, and traffic units varied about as much in degree. It is evident, therefore, that for the C. & N. W. the factor miles of all track is not nearly so erroneous in relation to traffic and revenues as "miles of road," but still presents a large margin of error. Let us see now how it works in the case of some other railroads in the West. On four other selected railroads, these being three in closest competition with the C. & N. W. and the other being a transcontinental line not reaching Chicago, the maximum variation ratios per mile of road to the mean or average range from 137% to 216% in the case of gross revenues per mile of road and from 135% to 236% in the case of traffic units per mile of road. In all track miles the variation ratios ran from 113% to 141% for gross revenues per mile of all track and 142% to 156% for traffic units per mile of all track. In every case studied, the maximum variation ratios when related to the average are substantially in excess of the mean or 100%,—sufficiently so to justify the statement that all track miles as an allocating factor, while not presenting nearly the percentage of error that does the factor "miles of road," nevertheless can be, and in the case of the average railroad extending into several states usually is, an offender in the respect that it imports values from one state to another.

The seventh factor is the ratio that the interstate commerce commission's appraisal in each state bears to the interstate commerce commission system appraisal.

Before entering into a discussion of the use of that ratio as an allocating factor, let me say that as to the use of I. C. C. appraisal in arriving at system value I am in emphatic disagreement with those who advocate the propriety of fixing system value by inclusion of I. C. C. appraisal along with the universally accepted stock and bond value and capitalized net railway operating income. I. C. C. appraisal from the standpoint of system value is historical only and since the advent of motor competition is obsolete. It reflects cost, or at most a value approximately two decades ago. When a state, as is its right, embarks on a comprehensive program of hard-

surfaced, high-speed highways, constructed side by side with its railroads, it is setting up a competing system of transportation and is thereby rendering obsolete and superfluous a large portion of the original railroad investment. Practically all of the states have done that and nobody questions their legal right to do it. But when a state has followed such a policy, is it fair or right that the same state, for taxation purposes, should treat the railroad as though the competing system of transportation, which the state has set up, did not exist? Yet that is what a state does when it puts I. C. C. appraisal into system value. But I am digressing from my subject, which is allocating factors.

There is no doubt that I. C. C. appraisal as an allocating factor gives an accurate measure of the relative cost of the properties in the various states. If cost were the controlling element in arriving at taxable value of a railroad the ratio of I. C. C. appraisal in a state to I. C. C. appraisal for the system would be an entirely acceptable factor. The defects in this factor are that it assumes an equality of value in each dollar of investment, or that an investment of \$1,000,000 in one state is as valuable as a similar investment in another state when the experience of the last twenty years has shown that this is not so. It does not allow, except as retirements have taken place, for the great changes in traffic and transportation trends that have taken place in the last two decades and particularly in the last ten years, not only from trucks but from crop restriction policies and tendencies to consume crops on the farm. The use of I. C. C. appraisal as an allocating factor also does not recognize the non-revenue producing character of a huge amount of railroad investment in populous states such as grade separations made before the government took over, as it has in the last four years, a large part of the cost of this type of public improvement. Perhaps with further studies to eliminate from I. C. C. appraisal those improvements made at railroad expense which are non-revenue producing in character, such as grade separations and track elevation, and following a program of branch line abandonment now in progress on many of the midwest railroads, this factor can be adjusted to make it useful and accurate.

The eighth factor is that of net earnings, and in my opinion, and I believe that of a committee of your association which once considered the subject, is utterly worthless as an allocating factor in the science of railroad accounting as we now know it. In theory, it would be hard to find fault with the statement that the profitable parts of a railroad should be assessed relatively higher than the non-profitable parts. The difficulty comes from the complex nature of the operations of an interstate railroad. Gross revenues can be divided with fair accuracy according to state lines as we have seen. But when it comes to railroad expenses we find a situation which

so far has defied the best efforts of students of railroad accounting to allocate by states. If we simply charge to a state all that is spent within the borders of that state we produce a wholly illogical result, since shops, terminals and general offices are located in some states which work as much for the benefit of lines in other states as they do for those in the states of location. The same train carries interstate and intrastate freight and the same car carries interstate and intrastate packages. Railroad operating divisions are set up without regard to state lines but for economy and efficiency of performance. While we know the expenses for the railroad as a whole, we do not have available any way of segregating expenses by states without such a vast and intricate system of keeping accounts that would be out of proportion to the benefits to be received, if indeed it could be done at all with any assurance of accuracy in the results. Where state and federal laws require some separation of net earnings by states, figures are submitted which, as to allocation of expenses, are based on the judgment of those who prepare them, but necessarily they are far from having the accuracy which attaches to allocation of gross revenues. Another defect in the use of net earnings as an allocating factor (taking the C. & N. W. as an example) is that more states show a loss than a credit to net railway operating income in each year from 1932 to 1936. If one followed, to its logical conclusion, the argument that net railway operating income as attempted to be allocated to the states is a measure of the value of the line in the respective states, the result would be that the lines of the C. & N. W. in more than half its states would be worth nothing. It is submitted, therefore, that net earnings constitute a wholly improper allocating factor. Most of the state taxing bodies in our territory no longer pay any attention to it.

After having discussed each of the eight allocating factors named, we come to the question "How great are the values imported into some states by the use of inappropriate allocating factors?" That necessitates starting with some kind of base which we call an appropriate allocation. From the study so far made it seems clear that the most accurate factors are traffic units and gross revenues. Suppose we take the composite of these factors and apply it to \$100,000,000 of system value on the C. & N. W. We take the figure \$100,000,000 simply for convenience in figuring mentally the percentages. We find the parts of the \$100,000,000 of value belonging in each of our nine states by the use of that composite of traffic units and gross revenues. Then let us take the remaining factors, one by one, and see which are wisest of the mark and which come closest, eliminating the eighth factor, that of net earnings, from the computation as being unworthy of consideration in any view. We find that the factor "miles of road," used alone, would export \$29,000,000 of the \$100,000,000 from three states and

into the other six states. Similarly, we find that the factor "miles of all track," used alone, will export about \$20,500,000 of the \$100,000,000 from the same three states to the other six states. We find that the factor "ratio of I. C. C. appraisal," used alone, will export about \$9,380,000 of the \$100,000,000 from two states to the other seven states. This factor transfers what had been the largest exporting state in the previous instances to the importing column. We find that the factor "transportation train miles," used alone, will export about \$8,500,000 of the \$100,000,000 from three states to the other six. Two of the three states here shown as exporters were also exporters in the first and second instances, those where the mileage factors were used. We find that the factor "car and locomotive miles," used alone, will export about \$7,500,000 from four states to the other five. Three of the four exporting states are the same as in the case of "transportation train miles."

It will thus be seen that when it comes to the importation of values through the use of unit rule formulae, disregarding the allocation factor net earnings as one generally disregarded by taxing bodies, the worst offender left as to the tests on the C. & N. W. is the factor "miles of road operated." Next in line is "all track miles," followed by "I. C. C. appraisal." "Transportation train miles" comes next and "car and locomotive miles" shows the smallest percent of variation from the composite of the two accurate use factors.

To test our conclusions we have made the same kind of computation as to the other four railroads referred to above, except that we did not have available their I. C. C. appraisal by states. As to the other four factors, miles of road, miles of all track, transportation train miles, and car and locomotive miles the importers of value were found in each case to rank in exactly the same order as on the C. & N. W. In other words, of those four factors, "miles of road" showed the greatest percentage of deviation, the factor "all track miles" came next, the factor "transportation train miles" was next, and the factor "car and locomotive miles" showed the least percentage of deviation, taking as the norm or standard the composite of traffic units and gross revenues. Of course the percentages were different and the spread in the case of the trans-continental line not reaching Chicago was less between the high and low importing factor than in the case of the other four lines.

In presenting this paper I have not attempted to give in detail the sheets of figures entering into these computations but only the results. However, the computation sheets themselves are available for inspection by any students of the problem who wish to peruse them at the close of my talk.

STATEMENT SHOWING VARIATION IN SERVICE UNITS OF PROPERTY WHICH AFFECT TAXABLE VALUES—DATA FOR YEAR 1936.

Railroad No. 1.

State No.	Data per Mile of Road		Data per Mile of all Tracks	
	Operating Revenues	Traffic Units	Operating Revenues	Traffic Units
3	\$32,077.20	2,407,563	\$12,262.78	915,706
17	12,664.85	898,874	7,745.90	545,587
8	6,232.17	484,560	3,570.96	283,266
9	4,470.15	367,056	3,490.94	286,507
5	12,898.49	1,062,839	8,187.85	671,550
13	2,035.46	172,873	1,712.05	145,406
15	2,721.11	178,666	2,351.66	154,222
12	4,199.37	260,251	3,428.52	212,111
18	4,403.85	291,098	3,414.83	225,051
Entire Line	\$10,855.41	809,685	\$6,909.79	513,416
Highest	32,097.20	2,407,563	12,262.78	915,706
Lowest	2,035.46	172,873	1,712.05	145,406
Variation	30,041.74	2,234,690	10,550.73	770,300
Ratio of variation to Entire Line . . .	277%	276%	152%	150%

The data shown above discloses that the transportation service as related to mile of road, mile of all tracks, varies widely in the different states served.

STATEMENT SHOWING VARIATIONS IN SERVICE UNITS OF PROPERTY
WHICH AFFECT TAXABLE VALUES.

Year 1936.

Road No.	No. States		Data per Mile of Road Operated		Data per Mile of All Tracks Operated	
			Operating Revenues	Traffic Units	Operating Revenues	Traffic Units
1	9	1. Entire Line	\$10,855	809,685	\$6,910	513,416
		2. Highest . .	32,077	2,407,563	12,263	915,706
		3. Lowest . .	2,035	178,666	1,712	145,406
		4. Difference .	30,042	2,228,897	10,551	770,300
		Ratio of 4 to 1	277%	275%	153%	150%
2	*12	1. Entire Line	\$9,855	910,081	\$6,565	609,023
		2. Highest . .	24,061	2,477,255	11,449	1,193,230
		3. Lowest . .	4,686	432,753	3,518	308,002
		4. Difference .	19,375	2,044,502	7,931	885,138
		Ratio of 4 to 1	197%	225%	121%	145%
3	11	1. Entire Line	\$10,926	1,061,912	\$7,003	682,665
		2. Highest . .	24,561	2,563,539	10,709	1,117,738
		3. Lowest . .	943	60,087	821	52,265
		4. Difference .	23,618	2,503,452	9,888	1,065,473
		Ratio of 4 to 1	216%	236%	141%	156%
4	8	1. Entire Line	\$9,202	823,242	\$5,904	528,128
		2. Highest . .	14,097	1,153,468	7,399	783,326
		3. Lowest . .	918	44,632	700	34,044
		4. Difference .	13,179	1,108,836	6,699	749,282
		Ratio of 4 to 1	143%	135%	113%	142%
5	6	1. Entire Line	\$4,344	371,854	\$3,544	303,357
		2. Highest . .	6,166	556,046	4,610	439,061
		3. Lowest . .	232	7,371	215	6,822
		4. Difference .	5,934	548,675	4,395	433,139
		Ratio of 4 to 1	137%	148%	124%	143%

* States omitted.

Revenue reported for 12 states only.

STATEMENT SHOWING RATIOS AND AMOUNTS OF TAXABLE VALUE IMPORTED
 INTO ONE STATE AND EXPORTED FROM ANOTHER STATE THROUGH
 THE USE OF VARIABLE ALLOCATING FACTORS AS COMPARED
 WITH AN ASSUMED NORMAL ALLOCATION.

Data applied to Year 1936 for Railroad No. 1.

State	Composite of Traffic Units and Oper. Rev.	Miles of Road Operated	Difference between Col. 1 and Col. 2 (3)	Value shifted from one State to another per \$100,000,000 of Taxable Value	
	Assumed Normal Ratio (1)	Ratio in each State (2)		Increase (4)	Decrease (5)
3	31.04%	10.46%	-20.58%		\$20,580,000
17	29.43%	25.80%	-3.63%		3,630,000
8	3.78%	6.40%	+2.62%	\$2,620,000	
9	3.17%	7.34%	+4.17%	4,170,000	
5	23.15%	18.50%	-4.65%		4,650,000
13	.04%	.17%	+.13%	130,000	
15	3.52%	14.98%	+11.46%	11,460,000	
12	4.61%	13.05%	+8.44%	8,440,000	
18	1.26%	3.30%	+2.04%	2,040,000	
Entire Line	100.00%	100.00%		\$28,860,000	\$28,860,000

STATEMENT SHOWING RATIOS AND AMOUNTS OF TAXABLE VALUE IMPORTED
INTO ONE STATE AND EXPORTED FROM ANOTHER STATE THROUGH
THE USE OF VARIABLE ALLOCATING FACTORS AS COMPARED
WITH AN ASSUMED NORMAL ALLOCATION.

Data applied to Year 1936 for Railroad No. 1.

State	Composite of Traffic Units and Oper. Rev.	Miles of all Tracks	Difference between Col. 1 and Col. 2	Value shifted from one State to another per \$100,000,000 of Taxable Value	
	Assumed Normal Ratio (1)	Ratio in each State (2)		Increase (4)	Decrease (5)
3	31.04%	17.44%	-13.60%		\$13,600,000
17	29.43%	26.96%	-2.47%		2,470,000
8	3.78%	7.08%	+3.30%	\$3,300,000	
9	3.17%	5.96%	+2.79%	2,790,000	
5	23.15%	18.57%	-4.58%		4,580,000
13	.04%	.13%	+.09%	90,000	
15	3.52%	11.00%	+7.48%	7,480,000	
12	4.61%	10.15%	+5.54%	5,540,000	
18	1.26%	2.71%	+1.45%	1,450,000	
Entire Line	100.00%	100.00%		\$20,650,000	\$20,650,000

STATEMENT SHOWING RATIOS AND AMOUNTS OF TAXABLE VALUE IMPORTED
 INTO ONE STATE AND EXPORTED FROM ANOTHER STATE THROUGH
 THE USE OF VARIABLE ALLOCATING FACTORS AS COMPARED
 WITH AN ASSUMED NORMAL ALLOCATION.

Data applied to Year 1936 for Railroad No. 1.

State	Composite of Traffic Units and Oper. Rev.	I. C. C. Appraisal	Difference between Col. 1 and Col. 2 (3)	Value shifted from one State to another per \$100,000,000 of Taxable Value	
	Assumed Normal Ratio (1)	Ratio in each State (2)		Increase (4)	Decrease (5)
3	31.04 %	34.07 %	+3.03 %	\$3,030,000	
17	29.43 %	25.46 %	-3.97 %		\$3,970,000
8	3.78 %	3.86 %	+.08 %	80,000	
9	3.17 %	3.87 %	+.70 %	700,000	
5	23.15 %	17.74 %	-5.41 %		5,410,000
13	.04 %	.05 %	+.01 %	10,000	
15	3.52 %	6.66 %	+3.14 %	3,140,000	
12	4.61 %	6.63 %	+2.02 %	2,020,000	
18	1.26 %	1.66 %	+.40 %	400,000	
Entire Line	100.00 %	100.00 %		\$9,380,000	\$9,380,000

STATEMENT SHOWING RATIOS AND AMOUNTS OF TAXABLE VALUE IMPORTED
 INTO ONE STATE AND EXPORTED FROM ANOTHER STATE THROUGH
 THE USE OF VARIABLE ALLOCATING FACTORS AS COMPARED
 WITH AN ASSUMED NORMAL ALLOCATION.

Data applied to Year 1936 for Railroad No. 1.

State	Composite of Traffic Units and Oper. Rev.	Trans- portation Train Miles	Difference between Col. 1 and Col. 2	Value shifted from one State to another per \$100,000,000 of Taxable Value	
	Assumed Normal Ratio (1)	Ratio in each State (2)		Increase (4)	Decrease (5)
3	31.04%	24.67%	-6.37%		\$6,370,000
17	29.43%	28.38%	-1.05%		1,050,000
8	3.78%	2.52%	-1.26%		1,260,000
9	3.17%	4.60%	+1.43%	\$1,430,000	
5	23.15%	24.88%	+1.73%	1,730,000	
13	.04%	.05%	+.01%	10,000	
15	3.52%	7.16%	+3.64%	3,640,000	
12	4.61%	6.34%	+1.73%	1,730,000	
18	1.26%	1.40%	+.14%	140,000	
Entire Line	100.00%	100.00%		\$8,680,000	\$8,680,000

STATEMENT SHOWING RATIOS AND AMOUNTS OF TAXABLE VALUE IMPORTED
 INTO ONE STATE AND EXPORTED FROM ANOTHER STATE THROUGH
 THE USE OF VARIABLE ALLOCATING FACTORS AS COMPARED
 WITH AN ASSUMED NORMAL ALLOCATION.

Data applied to Year 1936 for Railroad No. 1.

State	Composite of Traffic Units and Oper. Rev.	Car and Locomotive Miles	Difference between Col. 1 and Col. 2	Value shifted from one State to another per \$100,000,000 of Taxable Value	
	Assumed Normal Ratio (1)	Ratio in each State (2)		Increase (4)	Decrease (5)
3	31.04%	28.77%	-2.27%		\$2,270,000
17	29.43%	25.23%	-4.20%		4,200,000
8	3.78%	2.65%	-1.13%		1,130,000
9	3.17%	3.42%	+ .25%	\$250,000	
5	23.15%	27.93%	+4.78%	4,780,000	
13	.04%	.03%	-.01%		10,000
15	3.52%	4.29%	+ .77%	770,000	
12	4.61%	6.33%	+1.72%	1,720,000	
18	1.26%	1.35%	+ .09%	90,000	
Entire Line	100.00%	100.00%		\$7,610,000	\$7,610,000

SUMMARY OF AMOUNTS SHIFTED FROM CERTAIN STATES TO OTHER STATES
PER \$100,000,000 OF TAXABLE VALUE OF ENTIRE LINE THROUGH
THE COMPUTED USE OF VARIABLE ALLOCATION FACTORS AS
COMPARED WITH AN ASSUMED NORMAL ALLOCATION.

Data for Year 1936	Road No.	No. of States	Amount	Ratio to Total
Miles of Road Operated	1	9	\$28,860 000	28.86%
	2	14	17,910 000	17.91%
	3	11	19,030,000	19.03%
	4	8	13,640,000	13.64%
	5	6	21,080,000	21.08%
Miles of All Tracks Operated	1	9	\$20,650,000	26.65%
	2	14	13,100,000	13.10%
	3	11	12,090,000	12.09%
	4	8	11,180,000	11.18%
	5	6	17,550,000	17.55%
Transportation Train Miles	1	9	\$8,680,000	8.68%
	2	14	8,250,000	8.25%
	3	11	7,990,000	7.99%
	4	8	5,410,000	5.41%
	5	6	9,730 000	9.73%
Car and Locomotive Miles	1	9	\$7,610 000	7.61%
	2	14	3,350,000	3.35%
	3	11	3,280,000	3.28%
	4	8	5,280,000	5.28%
	5	6	4,620 000	4.62%

CHAIRMAN LELAND: I have asked Mr. Faricy to include with the report that is put into the *proceedings* a copy of the exhibits on which these statistics are based, so that those of you who are interested in some of his statistical work will be able to find it in the printed report of the conference.

However good an authority he may be on railroad matters, he certainly doesn't know much about the manufacturing business. He may be all right on his recipes for cooks, but if I know anything about the manufacturing business, he doesn't know much about it. When I was a boy one of my first jobs was to see that the manufacturer of a certain product didn't get too many rotten tomatoes in it, and if the percentage became too high, then we sold it in Canada.

So that while his argument may be perfectly good in some fields, you know it doesn't work very well in others.

Now we have these railroads all valued by units and allocated to states, and it remains only to assign to each taxing jurisdiction within the state its proper proportion of value. That is Mr. Ford's job, who will present his paper on "Intra-State Apportionment of Railway Valuations for Tax Purposes." Mr. Ford is acting director of the bureau of government, connected with the University of Michigan, a state and an institution that have had a long tradition in connection with railway taxation and railway valuation. I am glad to have Mr. Ford carry on.

INTRA-STATE APPORTIONMENT OF RAILWAY VALUATIONS FOR TAX PURPOSES

ROBERT S. FORD

Acting Director, Bureau of Government,
University of Michigan

The scope of this paper is somewhat broader than is suggested by the title, as I plan to discuss not only the apportionment of valuations, but also the apportionment of the proceeds of railway taxes when there is taxation at the state average rate on general property. These are aspects of the same problem of state and local tax relationships, but the emphasis is quite different in each case. Local tax autonomy is prominent when there is apportionment of valuations, while taxation at the state average rate represents an acceptance of state administration.

The predominance of the apportionment of valuations over state distribution of proceeds is due to the fact that local taxation of railroads was firmly entrenched in state fiscal systems before the adoption of the unit rule as a method of evaluating railway prop-

erty and central assessment of railroads.¹ The local units were unwilling to relinquish this source of tax revenue and with the rise of central assessment during the latter part of the 19th century, the statutes usually required the state board to apportion some share of the total assessment to the locality in which the railroad property was located. The present methods of apportioning valuations, therefore, represent a compromise between the old method of local assessment and that of state administration. On the other hand, Michigan and Wisconsin have adopted the method of state administration with taxation at the state average rate, leaving only the assessment of non-operating property to the local units.

The subject matter of this paper may be divided into two broad divisions, namely central assessment with apportionment of valuations and central assessment and taxation at the average state rate.

CENTRAL ASSESSMENT WITH APPORTIONMENT OF VALUATIONS TO LOCAL UNITS FOR TAXATION AT LOCAL RATES

In those states that follow the practice of central assessment with the apportionment of valuations to local units and taxation at local rates, the most common method of apportionment used is the ratio of the mileage of main track in the locality to the total state mileage of main track. This ratio is now in use in about twenty-five states. The Illinois method is assumed to be typical of state practices of this type, and a brief description is included here.

A. *The Illinois Method.*²—In Illinois the railroad track and rolling stock are assessed by the state tax commission. The railroad track³ is evaluated as a whole for the entire state and the valuation is apportioned among the taxing districts "in proportion that the length of the main track in such county, town, village, district or city bears to the whole length of the road in this state, except the value of the side or second track and all turn-outs and all station houses, depots, machine shops or other buildings belonging to the

¹ "Michigan shares with Pennsylvania, apparently the distinction of being the only state within the union in which the local taxation of railroads obtained no foothold." Wilbur O. Hedrick, *The History of Railroad Taxation in Michigan* (1912), p. 63.

² *Fifteenth Annual Report of the Illinois Tax Commission* (assessment year 1933), p. 156.

³ Railroad track consists of "right-of-way, including the super-structures of main, side or second track and turn-outs and the station and improvements of the railroad on such right-of-way." 1933 Ill. Rev. Stats., ch. 120, Sec. 42. Terminal facilities, including side-tracks, depots, switch yards and shops are properly classed as railroad track, to be assessed by the state board of equalization and cannot be assessed by the local assessor. *Quincey, O. and K. C. R. Co. v. People ex rel. Corrigan*, 156 Ill. 437; *Chicago and A. R. Co. v. People ex rel. Cooley, Collector*, 129 Ill. 571; *Peoria, D. & E. R. Co. v. Goar*, 118 Ill. 134; *Chicago and A. R. Co. v. People ex rel. Weber*, 99 Ill. 464.

road, which shall be taxed in the county, town, village, district or city in which the same are located.”⁴ According to the tax commission, this provision means “that after the value of the railroad is determined, there is certified to each taxing district the assessment upon railroad buildings, stations, etc., the residue being apportioned among the counties in proportion to main track mileage.”⁵ All of the movable property of a railroad is considered to be “rolling stock.” After the assessment by the state tax commission the valuation is apportioned to the counties according to the main track mileage ratio and taxed at local rates. The county clerk is then required to distribute the assessment within the county upon the same basis as was followed by the tax commission.

All other railroad property is assessed by the local assessor and taxed at the local rate by the jurisdiction in which the property is located.⁶

B. Problem of the Mileage Ratio.—This brief summary of the Illinois method will suffice as a basis for a discussion of the problem of fractional apportionment.

1. *Theory of the Apportionment of Valuations.*—The apportionment of valuations for local taxation is based upon the theory that only the districts in which a railway operates are entitled to tax and that only these districts should share in the distribution of the tax proceeds. It is true, of course, that the location of an expensive terminal within a city necessitates large outlays for fire and police protection, street facilities, etc. Nevertheless, the strength of this argument is often exaggerated.

Assume, for example, that a large oil field is discovered in one or two counties of a state. Should all or the major portion of the proceeds of the severance tax be returned to these two counties, or should a substantial portion of such proceeds be placed in the general fund of the state upon the theory that the state as a whole should derive some benefit from the discovery of this important natural resource? Naturally, these two counties will have greater outlays for police and fire protection and they are entitled to a fair share of the proceeds for these additional costs. It does not follow, however, that they are entitled to all of the proceeds because of the situs of the property. Or, the question might be directed to the township in which a large factory is located. Does the mere fact that the factory is located in that district mean that the state as a whole should not derive some benefit from the location of this large

⁴ Ill. Rev. Stats., *op. cit.*, Sec. 43.

⁵ Ill. Tax Com., *op. cit.*, p. 156.

⁶ “The tools and materials for repair and all of the personal property of railroads, except rolling stock, are assessed by the local assessor, who likewise values all real estate other than that known as ‘railroad track’.” Ill. Tax Co., *op. cit.*, p. 156.

factory within its boundaries? Similarly, in the case of a railroad, the state as a whole should share in the benefits arising out of the presence of a large railway system within its boundaries. Furthermore, a considerable portion of freight and passenger traffic may originate in counties in which none of the physical property is located. If it were possible to determine the origin of all traffic, it is probable that such a condition would be illustrated.

2. The Problem of Terminal Facilities. — One of the most common objections to an apportionment of valuations according to main track mileage is that it discriminates against metropolitan areas by the tendency to distribute the valuation of terminal facilities along the main line.⁷ A thinly populated area of a state may have many more miles of main track than a county in which expensive terminal properties are located, and the rural area will benefit through an apportionment on a main-track basis. It is thus a discrimination against the metropolitan area where a great deal of business is done on relatively few miles of track.

On the other hand, if the formula is based on all-track mileage rather than main track mileage, this probability will be minimized greatly. All-track mileage will reflect double track, sidings, etc., and it is fairly representative of the amount of business done.⁸

3. Should the Ratio be Weighted or Unweighted? — It may be contended that the use of the mileage ratio could be made more equitable by attaching a greater weight in the allocation formula to the auxiliary track than to the main track. For example, the location of expensive terminals in a metropolitan area may involve many miles of auxiliary track but relatively few miles of main track. Since the auxiliary track is necessary at the point where a great deal of business originates, it may be argued that this represents a more valuable part of the railway and that the auxiliary track should be weighted more heavily than the main track in the allocation formula.

This question was considered by a committee of the National Tax Association and it was their conclusion that "the trouble with this plan is that the amount of the extra weight to be attached to the auxiliary track is a 'shot in the dark.' To fix it at double or triple

⁷ In *People ex rel. Chicago et al. v. State Board of Equalization et al.*, 205 Ill. 296, (1903), the city of Chicago brought suit that railway terminal facilities should be assessed as real estate by local assessors, that is as property "other than main track." The court, however, denied the petition for a writ of mandamus to require the state board of equalization to divide the real estate of all railroads entering Chicago into "main track" and "property other than main track" and the apportionment method was construed to be reasonable.

⁸ "A Program of Tentative Suggestion, Supplementing a Previous Report of the Committee on Taxation of Public Utilities and upon the Inter-State Apportionment of the Tax," National Tax Association, *Proceedings*, (1923), p. 407.

or any multiple of the single-track value is necessarily arbitrary, and is based on nothing. While in theory it seems proper to give to the auxiliary track a greater weight than to the main track, the determination of the multiple to be used seems a serious obstacle.”⁹

4. Equalization. — In general, under the uniformity clause, there must be an equalization of the assessment on railway property and on other property. But how should this be accomplished when the assessment is made by a state board and the valuation certified to the local units for taxation? Should the equalization be made on the basis of the assessment ratio in the counties through which the railroad operates or should it be an average ratio?

If railroads are taxed at the rate prevailing in the districts through which they pass, then it seems that the equalization ratios in these respective districts should be used in computing the assessments. On the other hand, this method entails a considerable amount of detailed work and it may be that the results do not justify its use.

But if an average ratio is used, should it be an average of the districts through which the road operates or an average for the entire state? No figures are available to show the differences between these two sets of averages, but it is undoubtedly much simpler to use the state average. The Illinois Tax Commission reports that railroads of Illinois have consented to an equalization at the state average.¹⁰

C. *Composite Ratio*.—In view of the many difficulties that arise out of the use of the mileage ratio of apportionment, some attention should be directed to the question of a composite ratio. Reference has already been made to the use of a fraction consisting of main-track and all-track mileage, with different weights attached to each. The use of other factors that deal with railway activities is practically impossible because of the inadequate character of intrastate railway statistics.

It has been suggested that the use of certain factors unrelated to railway activities might improve the method of intrastate apportionment.¹¹ The use of indices of manufacturing, farming, construction, retail sales, savings deposits, etc., might relate the value of railway property to economic conditions within the region served. Along with the use of such factors, it might be well to include the all-track mileage ratio, which would reflect the value of terminal facilities. According to the Illinois Tax Commission, the present distribution of railroad assessment between Cook County and down state “is approximately 30 per cent to Cook County and 70 per cent to down state. Cook County has, however, over half of the population and almost exactly half of the total assessed valuation

⁹ *Ibid.*, p. 407.

¹⁰ 1933 Report, *op. cit.*, p. 197.

¹¹ *Ibid.*, p. 200.

exclusive of railroads. Furthermore, almost any series of economic data will show Cook County to have at least half or more of the economic resources of the state. A composite of such series, which may be referred to as an index of the relative economic means of the counties of the state, shows approximately 62 per cent for Cook County and 38 per cent for down state. . . . These measures of relative importance establish a *prima facie* case that railroad assessments might properly provide for an allocation of a larger portion of total valuation to metropolitan areas of the state."¹²

D. *Defects of Fractional Apportionment*.¹³—The preceding discussion brings out certain defects of fractional apportionment that may be summarized at this point.

1. From a theoretical standpoint it seems questionable to evaluate a railway as a unit and then proceed to segregate and apportion this unit valuation among local taxing units according to some arbitrary ratio, such as main track mileage."¹⁴ The Wisconsin Tax Commission has stated its dissatisfaction with the apportionment procedure in the following way: "Under the provisions of Section 76.08 (4) of the statutes, after the commission has found a unit value for the entire operating property of a railroad in the state, it must proceed to set aside a part of that assessment as the valuation of the terminal properties. The valuation of terminal property is largely based on an appraisal of the physical property. To set aside part of the unit assessment and give it a valuation comparable to the total railroad assessment is not possible with that degree of accuracy which the commission at all times seeks to attain."¹⁵

2. The intrastate apportionment of railway valuations is predicated upon the questionable assumption that only those districts in which the physical property of railroads is located may tax or share in the proceeds of railway taxes. Undoubtedly the jurisdiction in which valuable railway properties are located has a strong claim for taxation purposes. Large outlays are necessary for police and fire protection, street facilities, etc. Nevertheless, a great deal of traffic may originate in the jurisdictions in which no property is located.

3. According to the Illinois Tax Commission, the division of responsibility between the state and local units in the administration of railway taxes "has not been productive of the best results in the taxation of this important class of property."¹⁶

¹² *Ibid.*

¹³ From an administrative standpoint, there are certain advantages in the use of an apportionment fraction for interstate business.

¹⁴ An examination of the theory of the unit rule is beyond the scope of this paper. For a critical appraisal, see James C. Bonbright, *The Valuation of Property*, pp. 679-685.

¹⁵ *Report of Wisconsin Tax Commission*, 1930, p. 97.

¹⁶ 1933 Report, *op. cit.*, p. 155.

4. Even if a weighted average rather than a simple unweighted average is used, a number of difficulties are involved. The application of a weighted average can be nothing more than a "shot in the dark" because no one can supply the answer as to the relative weights to be assigned to the various factors. Whatever weights may be assigned are merely arbitrary with no scientific justification.

5. If valuations are apportioned only to those districts in which railway property is located, it may stimulate the gerrymandering of school districts to include railroad right-of-way. This situation seems to have developed in some states.

6. It may lead to discrimination between school districts within a county. "A railroad that serves a whole county often will pass through only a few of one hundred or more school districts within that county. The favored districts may actually have more money than they need, while other districts nearby are struggling for existence."¹⁷

E. *Alternative to Apportionment of Valuations.*—The problems arising out of the use of the mileage ratio and the nature of the defects of fractional apportionment suggest the futility of attempting an apportionment of valuations in this manner. A simpler, as well as a much more satisfactory method, appears to lie in the taxation of all of the operative property of a railroad at the average state rate, with the proceeds being placed in the general fund or in the educational fund for distribution to the local units. This will be discussed in the next section.

CENTRAL ASSESSMENT AND TAXATION AT AVERAGE STATE RATE¹⁸

Many of the difficulties involved in the intrastate apportionment of railway valuations for local taxation, according to main track mileage and other ratios, are eliminated with state assessment and taxation at the average state rate. The methods now followed in Wisconsin and Michigan will be described briefly to illustrate the difference in procedure.

A. *The Wisconsin Method.*—The entire operating property of railroads, which extends into two or more taxing districts, is assessed by the state tax commission and is taxed at the average state

¹⁷ Barnet Hodes, *Essays in Illinois Taxation*, p. 111. See also Henry C. Morrison, *The Financing of Public Schools in the State of Illinois*, The Educational Finance Inquiry Commission (1924), p. 58.

¹⁸ Minnesota and a few other states use a gross receipts tax instead of the ad valorem tax. While this is a means of avoiding the difficulties in the apportionment of railway valuations to local units, it involves the question of the relative advantages and disadvantages of gross receipts taxation as compared with the ad valorem method and it is, therefore, excluded from this paper.

rate. All non-operating property or property owned by a railroad that lies entirely within one taxing district is assessed locally.

Practically all of the proceeds of the railroad taxes remain in the state treasury except for the amounts computed to have been paid on railroad lakeport terminals. These "terminal taxes" are distributed to the cities in which the terminals are located.

Inasmuch as there is practically no intrastate apportionment in Wisconsin, attention here is centered principally on the computation of the average state rate. The statutes provide that the tax commission shall compute the average state rate of taxation by dividing the aggregate taxes levied by the aggregate true cash value of the general property of the state.¹⁹

It is significant that in computing the average rate, the figure of the true cash value of all general property in the state, as determined by the tax commission, is used rather than the actual assessed valuation of such property as determined by the local assessors. In this manner, according to the Wisconsin Tax Commission, "those companies which paid taxes at the average state rate have their taxes equalized with the taxes on properties which are locally assessed."²⁰

B. *The Michigan Method.*—The method followed in Michigan is quite similar to that in Wisconsin. Railroads are subject to the specific tax on their operating property and it is assessed at its true cash value by the state tax commission at the average state rate of taxation.²¹ The specific tax is in lieu of all other property taxes for state and local purposes, excluding special assessments made in any county, city, village or township. Non-operating property of railroads is subject to local assessment and taxation at local rates.

The method of computing the average rate in Michigan differs from that of Wisconsin in that the Michigan Tax Commission is required to use the total assessed valuation as determined by the local supervisors and assessors, whereas Wisconsin uses the true cash value as determined by the state tax commission.²² Under the Wisconsin plan the average rate is theoretically the true average rate and the assessment of railroad property with general property is automatically equalized. In Michigan, however, this is impossible with the local assessment serving as the basis of the average rate. Efforts at equalization along the lines now followed in Wisconsin were attempted in the past but the use of the true cash value, as

¹⁹ Wisc. Stats., Secs. 76.09, 76.12, 76.14.

²⁰ *Report of Wisconsin Tax Commission*, 1930, p. 88.

²¹ *P. A. 1905*, Act 282; *P. A., 1909*, Act 45; *P. A. 1917*, Act 339.

²² The determination of the average rate by simple mathematical calculation cannot be objected to on the ground that there has been no legislative determination of the rate. *Michigan Central Railroad v. Powers* (1905), 201 U. S. 245.

determined by the state tax commission, was held to be inconsistent with the constitution and to be a fictitious value.²³ If there is any equalization between railroad and other property, therefore, it must be by such an adjustment in the original assessment as will produce an approximate equality in the tax burden.²⁴

In general the proceeds of the tax on railroads, as well as other public utilities, are placed in the primary school interest fund and distributed to the local units according to the school census in each district.²⁵ The distribution is made to the county treasurers who remit the amounts as allocated to the respective school treasurers.

C. Problems of the Average Rate.—Theoretically, the tax rate on railroads should be fixed with reference to the tax burden on other property and business within the local taxing district. With the application of the unit rule, however, it seems sufficient that the assessment be made with reference to the tax burden on property for the state as a whole.

1. *Equalization of Railway and Other Property.*—The problem of equalization between railway and other property is focused to a considerable extent in the valuation which is used in computing the average rate.

As has been mentioned previously, the use of the assessed valuation as determined by the state tax commission is probably more desirable than a summation of the local valuations because the former tends to equalize automatically the assessment of railroad property through the state. The question may arise, of course, as to

²³ In 1902 the board of assessors attempted to equalize the assessments on railroad and other property by raising the total assessed valuation as determined by the local assessors and supervisors to what the commission had determined was the true cash value. This, of course, lowered the average rate of taxation, reduced the amount of railroad taxes, and diminished the apportionment of railroad tax proceeds to the local units. The assessment was questioned in *Board of Education of Detroit v. Board of State Tax Commissioners*, 133 Mich. 116, and the state supreme court sustained the complaint and ordered a redetermination of the rate.

In 1905 the so-called Galbraith law was passed which provided for a determination of the true cash value of general property by the board of tax commissioners as a basis for determining the average rate. However in *John E. Bird, Attorney General v. Board of State Tax Assessors*, 143 Mich. 73, the law was invalidated on the ground that the constitution required the state assessors to determine the average rate which was actually levied on other property and that the use of a fictitious sum as a divisor for determining the rate would be unconstitutional. See H. L. Lutz, *The State Tax Commission*, p. 309 f.

²⁴ Lutz, *op. cit.*, p. 311.

²⁵ All taxes collected under this act shall be applied in paying the interest upon the primary school, university and other educational funds, and the interest and principal of the state debt, in the order herein recited until the extinguishment of the state debt, other than the amounts due to educational funds, when such taxes shall be added to and constituted a part of the primary school interest fund. *P. A. 1905, Act 282, Sec. 3568.*

whether it is possible for the tax commission to determine the true cash value of general property. However, it is highly probable that they will do this more satisfactorily than a multitude of local assessors. According to Professor Lutz, "the Wisconsin practise of equalizing the rate of taxation on corporate property centrally assessed is a valuable precedent for the equity of this procedure."²⁶

2. The Effect of Tax Rate Limitations on the Average Rate.—Some question may arise as to the probable effect upon the average rate of the adoption of an over-all limitation on the tax rate. In 1932 the state of Michigan adopted a constitutional amendment providing for an over-all limitation of fifteen mills on the general property tax rate. The limitation was to apply only to taxes for operating purposes and for debt service on any new debts incurred after December 8, 1932, the effective date of the property tax limitation act. It does not apply to that part of the tax levy which is used to pay principal and interest on debt incurred prior to December 8, 1932.

In 1933, the first year in which the limitation became effective, the average rate was reduced to \$27.39 per \$1,000 of assessed valuation, which represented a decline of 16 per cent from the rate of \$32.79 per \$1,000 in 1932. In 1936, the average rate was \$25.57 per \$1,000. Future reductions in the average rate may be anticipated as the debts, which were incurred prior to December 8, 1932, are liquidated and the levy for debt service is correspondingly reduced. Such a tendency may be counteracted, of course, if the local units vote approval of new projects to be financed by borrowing.

3. Distribution of the Proceeds.—A basic reason for the use of the device of the average state rate is to avoid the difficulty of segregating and apportioning the unit assessment according to the location of property. If it is proper to evaluate railway property as a unit and tax it at the average state rate, it seems equally proper and equitable to use the proceeds of such taxes for a general welfare purpose, such as education, or to place the proceeds of the tax in the state general fund. This may be offered as a justification for the Michigan method, although the question of the equitable distribution of railroad tax receipts did not influence the adoption of this method. According to Hedrick, "The Michigan plan of yield division was shaped by the practical needs of the state school system and by the accidental relations between this system and the railroad building fund and was uninfluenced by any theory of division whatsoever. . . . But while of an accidental character, it harmonizes measurably with the requirements of good theory in its method of distribution among the localities."²⁷

²⁶ Lutz, *op. cit.*, p. 311.

²⁷ Hedrick, *op. cit.*, p. 61.

COMPARATIVE EFFECTS OF THE TWO METHODS

The preceding discussion has developed some of the problems and relative merits of the two methods. There should be some consideration of their probable effects although so many factors are involved that comparison is practically impossible.

Whether the effects on metropolitan areas are greatly different under the two methods is an unsettled question. In Michigan, Detroit and Wayne County have about 50 per cent of the population and half the assessed valuation of the entire state. In 1936, 36 per cent of the proceeds of the primary school interest fund, to which the railroads are the principal contributors, were allocated to Wayne County on the basis of the school census. A similar situation exists in Illinois where Chicago and Cook County have approximately 50 per cent of the assessed valuation and population. For the assessment year 1933, approximately 30 per cent of the railway valuations in the state were allocated to Cook County.²⁸

This suggests that the effects of either method do not differ greatly in metropolitan areas. On the other hand, the results may be quite different in rural districts in which no railway property is located. Under the Illinois plan such districts would receive no apportionment of railway valuations, whereas in Michigan they would receive an apportionment from the primary school interest fund according to the number of school children between the ages of five and nineteen years in the district.

CONCLUSIONS

From the theoretical and administrative standpoints the taxation of railroads at the average state rate seems to be superior to the intrastate apportionment of railway valuations for local taxation. However, from a more practical standpoint the two methods should not be considered apart from the particular fiscal and political system in which they operate. The Michigan method works well in Michigan, but it might be very unsatisfactory in Illinois. The shift to the plan of taxation at the average state rate might force substantial readjustments in state and local tax relationships and thus nullify most of the administrative advantages. The method now followed in Michigan was adopted as a practical plan of dealing with the problem of school finance without any consideration of the theory of distributing the proceeds. I daresay that a similar situation existed in other states where valuations are pro-rated on a main track mileage basis. If this is the case, there would seem to be little hope of eliminating the discrimination against metropolitan areas. The contention that a high ratio of the state's total assessed valuation and population justifies a greater share of the valuation or yield may be turned into an argument to show that the presence

²⁸ Derived from *Report of Ill. Tax Com.*, 1933, Table 10, p. 491.

of such a high ratio of the state's total assessed valuation and population indicates other sources of tax revenue in the metropolitan area which are not available to less prosperous sections.

In other words, present methods of taxing railroads constitute an integral part of state and local tax systems. The fiscal systems in those states that pro-rate valuations are adapted to the method under which certain counties participate in the taxation of railroads while other counties do not. The method of pro-rating valuations may appear inequitable and unsatisfactory on the surface, but any revision will probably be made because of changing financial requirements rather than because of any theoretical defects in the method. When the tax law in any state is rewritten or revised, a change in the taxation of railroads will probably force a corresponding adjustment in state and local tax relationships.

CHAIRMAN LELAND: I might say for the benefit of those of you who are not familiar with the Illinois statute that the method of distribution which Mr. Ford described has been changed since he started writing his paper, and that instead of distributing now on the basis of main track mileage, which has the obvious inconsistencies that he mentioned, Illinois will, beginning next year, make its distribution among the counties on the basis of all track rather than on the basis of simply main track mileage.

The main papers on this program have been completed. It is now time for the fireworks. We throw this open to general discussion on the part of our listed discussors, after which we hope there will be a lively discussion from the floor.

The first person to discuss these papers will be Mr. A. H. Stone, chairman, Mississippi State Tax Commission.

Each person is limited to eight minutes, and we shall try to enforce that rigorously.

A. H. STONE (Mississippi): Mr. Chairman and Gentlemen: When Mr. Leland first suggested that I take part in this discussion of railroad valuations for assessment purposes, I frankly told him that I knew nothing about railroad valuations, and very little, personally, about railroad assessments. I will not be certain about it, but my impression is that he replied that this admission did not disqualify me.

After listening for many years to more or less learned discussions, by more or less learned gentlemen, of the subject of values and valuations, in general and in particular, as to railroads, power lines, real estate, tangibles and intangibles, I am reminded of a story which was current during the Bryan-McKinley presidential campaign of 1896. Mr. Bryan insisted that there was really nothing complicated about the financial question—that any schoolboy could understand it and know all about it. Somebody, it must have been

a Republican, took this as a text for the story. A school teacher asked one of her pupils to tell her what was seven times nine. The boy made no reply, until urged for an answer. He then said that he did not know and he did not believe that anybody else knew. This, of course, is foolish and far-fetched—but you catch my meaning. I do not know what is railroad value, and I question whether anybody else knows. In any event, we have men of equal ability, knowledge, honesty, and experience on both sides of any phase of the railroad and general utility valuation problem. They cannot all be right. They cannot all be wrong. At the same time, all of us, state tax men and railroad tax men, must get together on some figure and call it value.

Take the papers which have just been presented here, within the past hour or so. They are by men whose ability and intellectual honesty are beyond question. Yet a variety of conclusions might be justified by these discussions. But the one thing which they most impressed upon my mind is the necessity for the exercise of common sense and fair play in valuing railroads, as in every other human undertaking. This to me is the outstanding conclusion of the papers as a whole.

I have said that I, personally, am not a railroad valuation expert. I am not any kind of a tax expert. I am a tax commission administrator. By the letter of the law, I am technically and actually responsible for collecting taxes to the extent of more than seventy per cent of my state's total revenues. I have to administer nine different tax laws. But, personally, I do not collect one dollar of taxes. I adopt the common-sense policy of setting up a division for each tax, or for a combination of two or three, and putting a man in charge of each division, and holding him responsible for results. Of course, I am in constant conference with the men in the office and from the field, and am officially responsible for their selection and for the results they secure.

And so with railroad and other utility valuations and assessments. As chairman of our commission, I am, of course, responsible for what the commission does in the way of all utility assessments. But as a common sense procedure, we secured the services of a valuation engineer of character, experience and ability, Mr. W. H. Wallace. Incidentally, you may be interested to know that he was suggested and recommended to us by our dear old friend, the friend of all of us, and one of the patron saints of the National Tax Association, Dr. Thomas S. Adams—or as we affectionately knew him, Tommy Adams. The head of our utility assessing division is our ad valorem commissioner, Mr. Bruce Van Zandt, one of the fairest and most common-sense men on any tax commission in this country.

The basis of our operations is cooperation rather than coercion. We give the taxpayer the benefit of the doubt. We apply this policy

to our utility assessing duties just as we do to our tax collecting responsibilities. And I am glad to say that the utilities in the main have responded to this policy and have cooperated with us. After accumulating all the data and information available to our valuation section, we apply it to our assessing problems, with the saving grace of common sense. This means that we give weight to every factor which has any place in a valuation decision—as measured by the rule of reason and common sense, rather than by some technical valuation formula. Let me illustrate by reference to one factor which I do not think has even been mentioned in any of the discussions today. This is the human factor. I knew Stuyvesant Fish when he was president of the Illinois Central Railroad, many years ago. Mr. Fish took an intense personal interest in the territory served by his railroad. He was probably as well acquainted with it as the elder Jim Hill was with the territory served by the Great Northern. Mr. Fish took a just pride in knowing the people of his territory, knowing and meeting their wants and needs. I have heard him say more than once that he could stop off at any town of 2,500 or 3,000 people along his system and greet from one to half a dozen men by their first name. I also have in mind some three or four of the smaller railroads. These roads are not as long as the Illinois Central, but they are just as wide. These lines are largely, I am almost tempted to say absolutely, dependent upon the personal factor. I could mention two or three of them whose value would hardly be worth considering, if separated from the personality of their presidents. Such factors may be said to be intangible and not subject to appraisal in arriving at railroad values. Perhaps so. But this only adds to the complexities of the problem; for though intangible, they are none the less real.

I am to be followed by some really expert gentlemen in the utility valuation field, and I shall now step aside for them.

CHAIRMAN LELAND: The next discussion will be by Mr. R. C. Beckett, general attorney of the Illinois Central System, Chicago.

Mr. Beckett, it is a pleasure to present you to this audience.

R. C. BECKETT (Illinois): Mr. Chairman and Gentlemen, I took the trouble to shake hands with Mr. Mott before I came up because I was particularly assigned to discuss Mr. Mott's paper. I thought I had better shake hands with him in advance.

The subject Mr. Mott discussed, if you remember, was the weight to be given physical appraisals in determining unit value assessments for railroads. Mr. Mott's paper covers the subject very beautifully and in a manner that I think no one can disagree with as to his conclusions. Certainly I don't disagree with them. He stated, in the first place, that the unit value concept is essential in the valuation of a large railroad system. I know of a few here present who would disagree with that, but I don't.

There are some gentlemen here, from New Jersey in particular, who don't agree with that concept. They are engaged in a very important and most bitterly fought lawsuit to test the validity of that statement, as they contend that anything outside of New Jersey is entirely foreign and any concepts of valuation outside of New Jersey don't appreciate the importance of the Hudson River, which is the gateway to the whole world. There is nothing like it in the country. That is probably the one exception in the United States of an important tax-assessing body that refuses to admit any weight to the unit concept in the valuation of a railroad.

I hope I may be pardoned for taking just a few minutes to present a little of the idea so that something may be presented here during my eight minutes which may belong in the constructive category that the chairman has applied only to those who had papers to read and not to us who talk at random.

They say that they can't use the unit concept of value of their railroads because no allocation factor gives full effect to the value of that terminus. That is really the fundamental and the big question in those lawsuits that have been pending there for several years which involve so many millions of dollars. While that has been illumined with many sidelights and bursts of brilliance, both of humor and fact and detail, that is really what they are litigating about, and the one single question. Because if unit value can be applied the railroads have a very good case, and if unit value cannot be applied there is nothing else but the reproduction-cost basis, which is fortified by the New Jersey people by designating their reproduction-cost book as the "bible."

The "bible" is a book compiled by each railroad. Its beginnings were based on the physical appraisal system started in the state of Michigan, called the Cooley-Adams method, and in 1911 the New Jersey people brought over one of the Cooley-Adams staff and they started a physical appraisal. That physical appraisal has been kept down to date to the present time by net additions and betterments and that is the "bible" to which they go to determine values.

But they retain some room for the exercise of judgment. They have the physical appraisals, consisting of estimated reproduction cost as of 1911 determined by Mr. Hanley, plus net additions and betterments in cost since that time, but less depreciation. They can exercise their judgment on the subject of depreciation. So that when the depression came there was a little more depreciation allowed than had been customary theretofore, thereby giving some reductions but not large in amount—that is, not as large as the railroads wanted. That is, in the use of the physical appraisal in determining the valuation of railroad property, the New Jersey system certainly gives it greater weight than any other state.

Mr. Mott stated that the importance of historical cost decreases with time. I think that is a very important part of his paper. When a property is perfectly new its cost is what the people who built it thought that it would justify, or they wouldn't have built it. But as their judgment is tried in time and its earning power is established over a period of years, and possibly the management may have changed hands once or twice so that there is no question of at least average good management, then the actual historical cost disappears entirely, as an element improving taxable value.

I think no one can disagree with that statement.

Then it is said that reproduction cost is sometimes considered a limit of value, at least of competitive industries. Of course, that does not include railroads except in the sense that if there was room to build another railroad paralleling one railroad built and able to get the same business, then the reproduction cost might be considered a limit of the value, because if it were not, then another structure could be built of the same cost, which would destroy the excess over the reproduction cost value.

That doesn't have very much practical use, except it is a statement that was recently made in a decision of the court of appeals of the state of New York, their highest court, which does state that the reproduction cost is the limit of value and that its actual value is less than that if its earning power is less. They left a loophole in that excess of earning, however, over reproduction cost might be assessed as franchise value, as they do in Kentucky.

Then the statement is made that no formula can be used which is absolute, and that formula merely sets limits outside of which true value cannot be found. I think that is the way the courts look at formulas which they frequently copy in their opinions, and cite the various figures produced by these formulas as being circles beyond which the exercise of judgment cannot go. I think that is a very sound concept.

It is frequently said that the value cannot be determined by formulas because they must consider location and traffic, and various general terms, but terms which cannot be converted into dollars. Assessments must be made in terms of dollars, and almost the only things you have which can be converted into terms of dollars are earnings, stock and bond prices, and some features of cost prices, the reproduction cost, historical and actual cost.

So that the formulas are truly said to merely set limits outside of which true value cannot be found.

In conclusion the statement is made, that physical appraisals should be given minor weight in valuation of a system, but they may be given great weight in apportionment between taxing districts. I think no fault can be found with that.

I had hoped that Mr. Mott would go a little further. There is one merit that occurs to me in courts and judges as compared with economists. Courts at least come to a definite decision after they are through talking. Economists frequently do a lot of talking without getting down to a definite result for fear it may be wrong. Everything in Mr. Mott's paper I think is such as practically everyone would agree with, but tax commissioners are faced with the problem of whether or not they shall use in some definite way physical appraisals in producing their assessments, and we know that to a certain extent they are sometimes used.

I would like to know how they are used, if at all, in California. I know they are used in New Jersey. I know they are used to a certain extent in Illinois, which I would be more indignant about except they serve a purpose which may be explained in that they cushion the decline. They cushion the reductions which would otherwise result from applying the other methods of ameliorating. I have heard the chairman of the Illinois commission, Dr. Leland, frequently expound the merits of cushions. I think he must have had some experience with the merits of cushions when a small boy. At any rate, he is a believer in cushions. Coming from the South, I am naturally a rebel. In facing the problem more courageously than any commission that I know of, of changing valuations in accordance with somewhat reasonable and scientific methods, they have done it by changing individual roads in accordance with results produced by scientific methods instead of arbitrary ones more than any other commission, facing the resentment of the local bodies that are losing large amounts of taxes and the unexpressed thanks of those who gain by that but do not express it so much. The most usual method of assessing railroads is to begin with last year's assessment. I think in at least three-fourths of the states I know anything about, this is the formula: look at last year's assessment, and look up at the ceiling and think whether they ought to have a little reduction or a little raise, or whether it would be better to make it a general raise or a general reduction of five per cent for everybody. But at least the Illinois commission has not used that method. They have evolved a formula which they are willing to disclose and to discuss and to show the steps, as the Wisconsin commission does, and to discuss the results and then to trend their assessment toward that result.

That result of using exactly results produced by formulas was achieved this year, I am told, in one state. For the first time in twenty years, I was told by the statistician of Iowa, their assessments were the exact results produced by their formula, and a dream had come true which they had been working toward for twenty years.

CHAIRMAN LELAND: Mr. Beckett has referred to the comments concerning the valuation methods in New Jersey. I have a statement here on Mr. Mott's paper left by Commissioner Martin of New Jersey, which I will read into the record at the end of our regular discussion.

I also know that in the audience is Mrs. Sweany of Iowa, and I hope we may have a few words from her as to her Iowa experience after we have finished our regular discussion.

The next person to lay a barrage will be our good friend, Professor James W. Martin, commissioner of revenue of the commonwealth of Kentucky.

JAMES W. MARTIN (Kentucky): In commenting on the address delivered by Mr. Faricy I should like to begin by expressing cordial appreciation of his excellent paper on the allocation of railway property as between the states. I find myself in substantial accord with the principles Mr. Faricy has outlined; and what I shall say, therefore, may be regarded as supplementing, rather than criticizing, the original discussion.

From what Mr. Faricy has said it seems to me that, satisfactory as traffic units and allocated gross receipts may be from the point of view of fixing the origin of the operating income of a railway system, the use of these two factors alone neglects certain considerations which ought not to be ignored.

In the first place, there is an element of cost of service involved in protecting tangible property as such; and for that reason some emphasis on the existence of actual structures as distinguished from income-earning elements should probably be reflected in a composite allocation factor. Probably the most directly usable factor to utilize in reflecting this consideration is reproduction cost new, as determined by the interstate commerce commission, plus net additions at cost. However, all track mileage may be employed effectively for this purpose.

In the second place, it is commonly accepted that the most reasonably available basis for allocation as between taxing districts within a state is all track mileage. Since this is the case, it would appear that for psychological reasons, if not on grounds of principle, all track mileage ought to be an element in the composite factor employed for allocation of railroad properties as between states.

In the third place, there is an element of value from the income-producing point of view inhering in connections between points involving the use of terminal facilities which probably should be reflected in the composite allocation factor. In other words, it may be, and doubtless sometimes is, the case that the connection between two terminals is more important from the income-producing point of view than the volume of freight and passenger traffic as reflected by any sort of use factors would indicate.

For these several reasons it appears to be likely that a composite factor utilizing traffic units, gross receipts, reproduction cost new plus net additions at cost, and all track mileage may more accurately reflect the proper allocation of railroad property as between states than would the first two of these factors taken alone. It would be desirable to work over the situation comprehensively from the point of view of testing such a composite formula. But *a priori* the factor made up of four elements would seem more defensible, particularly when presented to persons not intimately acquainted with railroad practice, than would any simpler allocation plan. (I agree entirely with those who have appeared on the program this afternoon that a proper allocation plan should seek a logically defensible apportionment of system values, and should not be assumed to result in the market value which that part of the system in any particular state standing alone would have.)

If the suggestions supplementary to Mr. Faricy's discussion which I have presented are sound, they argue strongly for a canvass of the statistical section of Mr. Faricy's discussion to ascertain the extent of misplacement of values by reason of inaccurate allocation formulas ordinarily applied. It is strongly suggested that the importation of values arising from the use of the four-factor formula would be less than the distorting influence which would occur from the use of two factors, namely, traffic units and allocated gross receipts, which is implicit in Mr. Faricy's suggestion. If this is the case, then the statistical analysis suggested would require an examination of the displacement effected by each of the items Mr. Faricy has found in practice, including the use factors such as traffic units and gross receipts.

In other words, while I agree thoroughly with Mr. Faricy that traffic units and gross receipts constitute individually the most defensible elements in the allocation formula, I think, as indeed he suggests, that either of these factors employed alone would distort the truth; the two employed together would distort it less; and these two employed with all track mileage and reproduction cost new plus net additions at cost would distort the picture still less. It is superfluous, perhaps, to say that I have not examined the facts with sufficient care to justify a judgment as to whether in a four-way composite allocation factor there should be a scheme of weighting, or whether the unweighted average would be substantially as good. For reasons of simplicity I am inclined to think that an unweighted average would give entirely defensible results by means of a statistically simple technique.

CHAIRMAN LELAND: The next speaker on the program is Mr. William Mueller, tax commissioner of the Chicago, Minnesota, St. Paul and Omaha Railroad.

WILLIAM MUELLER (Minnesota): I fail to understand why Professor Leland should have selected me to discuss Mr. Ford's paper on "Intra-State Apportionment of Railway Valuations for Tax Purposes," as our little railroad with the big name (Chicago, St. Paul, Minneapolis & Omaha Railway Company) operates only in five states (Wisconsin, Minnesota, Iowa, Nebraska and South Dakota) in two of which (Wisconsin and Minnesota) the railroads pay taxes directly to the state treasurer in lump sums, leaving only three states in which we pay to the county treasurers on valuations fixed and apportioned by the state taxing authorities to the various political subdivisions of the state through which the lines operate. Hence my experience in such matters has been rather limited and I therefore read Mr. Ford's paper with a great deal of interest and wish to congratulate him upon the thorough manner in which he has covered the subject.

As it will not be possible for me to go into much of a discussion of the many questions he has referred to in his paper within the time allotted to me I shall content myself by describing briefly the methods of apportionment used in three of the states with which I am familiar, viz: Iowa, Nebraska and South Dakota.

IOWA

In Iowa the total assessed valuation of a given railroad is fixed by the state board of assessment and review and apportioned to the various political subdivisions through which its lines operate on a uniform value per mile of main track basis regardless of the amount and value of the property within each political subdivision, on which valuations taxes for all purposes are paid through the county treasurers. I do not have available any recent figures as to what proportion of the total railroad taxes paid in the state was used for city and village purposes but of the total taxes paid by our company on its railroad operating property in Iowa for 1936 approximately 20% went to the cities and villages which have approximately 16% of our Iowa main track mileage within their corporate limits.

NEBRASKA

In Nebraska the state board of equalization and assessment fixes a uniform value per mile of main track separately for each line or branch of a given railroad to which valuations all taxes—except those for city and village purposes in incorporated cities and villages—are applied by the county clerks in making up the tax rolls, or, as one authority on Nebraska taxation puts it, "Originally the total state valuation was distributed to the various counties on the basis of an average of all track mileage and gross earnings, but for a number of years the allocation to the counties has been made only on the basis of mileage. The original valuation has been in-

creased or decreased in accordance with the state's share of the system valuation, and from this has been found the county's share based upon the mileage reported. If there was no change in mileage, but an increase in system valuation, for instance, the county's share of the increase was made proportionate to the system increase within the state."

For the cities and villages they have a so-called "terminal" tax for which the assessments are made in the first instance by the local authorities, which assessments cover all of the tangible property of the company within such incorporated city or village. These assessments are sent to the county assessors and by them in turn to the state tax commissioner and after equalization by the state board there is added thereto the assessed value per mile for the rolling stock of the company as fixed by the state board and the total certified to the county clerks and used by them in making up the tax rolls. Of course, only the tax rates for city and village purposes are applied to these so-called "terminal" valuations. Of the total amount of railroad taxes paid by our company in Nebraska for 1936 the "terminal" taxes represent approximately 40%, more than one-half of which went to the city of Omaha, while only 12% of our total Nebraska main track mileage lies within the incorporated cities and villages.

SOUTH DAKOTA

In South Dakota the assessment of all railroad operating property is entirely in the hands of the division of taxation of the state department of finance which after determining the total amount of the state assessment for a given railroad apportions such total amount to the various political subdivisions on a pro-rata physical value basis according to the detailed reports required from the railroad companies, except that the assessment of railroad operating property outside of cities and incorporated towns is based on a uniform value per mile of main track as fixed by the division of taxation for each line or branch plus the value per mile of side track also fixed by the division of taxation, which value per mile is uniform for all side track of a given railroad within the state outside of the cities and incorporated towns. With approximately 16% of our main track mileage in South Dakota within cities and incorporated towns approximately 25% of our total 1936 South Dakota taxes was paid to such municipalities.

CONCLUSION

Speaking only of the three states just above referred to and as a representative of a taxpaying railroad I prefer, of course, the method of apportionment on a uniform valuation per mile of main track basis as used by Iowa on account of its simplicity, while, view-

ing it from the standpoint of equity as between various political subdivisions I should have to favor the plan used by the state of South Dakota where the cities and incorporated towns are given a larger share in the apportionment.

However, I prefer the Wisconsin method to any of the others, for, to give certain political subdivisions no share of the taxes paid by the railroads because they do not happen to have a railroad within their borders although they may contribute very largely to the traffic carried on the railroads of the state, seems to me to be very unjust, but, as Mr. Ford so aptly says, "From the theoretical and administrative standpoints the taxation of railroads at the average state rate seems superior to the intrastate apportionment of railway valuations for local taxation. However, from a more practical standpoint the two methods should not be considered apart from the particular fiscal and political system in which they operate." While one plan might work very well in certain states the same plan might work very unsatisfactorily in other states, depending very largely upon their fiscal systems.

CHAIRMAN LELAND: Mr. D. H. Worrall, tax agent of the Pennsylvania Railroad Company, located in Philadelphia and most everywhere else, is the next speaker on the program.

D. H. WORRALL (Pennsylvania): Mr. Chapman's paper on "Use of Railway Statistics and Accounts in Determining Taxable Valuations" is a very able and fair discussion of the classes of evidence which have come to be relied upon by tax administrators and courts. It is not surprising that Mr. Chapman was unable to indicate the weight to be given to the three primary measures. He very wisely summarizes the subject with the statement that "... any formula ... should be considered only as indicative of value ..."

I am sorry that Mr. Chapman limits his discussion to "system unit valuations." The tax laws of the states vary widely, some taxing on physical property; some, on capital stock; some, on earnings, gross or net or both; and some, on combinations of bases. Many situations arise in which the use of "system unit valuation" may produce unjust results. The practical aspects of determining "system unit values" may also detract from the value of this base. Direct evidence is often available as to the market value of stocks and bonds, as to the earning capacity and as to the cost of reproduction less depreciation of a company, even if operated as part of an integrated group of companies which may be designated a "system." In such cases it is difficult to see the necessity of building up a "system unit value" and then allocating figures which contain much extraneous and irrelevant data to attempt to establish a value for a property as to which direct competent evidence is ready.

Little can be added to Mr. Chapman's able review of the dangers and pitfalls involved in the use of market value of stocks and bonds

as an indication of value. Collateral to this is the question of deductions. Deductions fulfill a three-fold duty:

First—Eliminate non-taxable classes of property and assets.

Second—Eliminate property and assets not used in railroad operation.

Third—Avoid double taxation.

It is obvious that if the property and assets to be eliminated are valued at their market prices or the equivalent, the basis used in fixing the value of stocks and bonds, the restrictions suggested by Mr. Chapman become unnecessary. The sole test necessary is whether or not the property or assets fall into the class to be eliminated, and being in the deductible class, the deduction should be made irrespective of the purpose for which held, as the benefits of ownership are reflected in the total measure. This is particularly true as to locally assessed and taxed real estate. If this class of items is not eliminated to the extent already taxed, duplicate taxation cannot be avoided.

Mr. Chapman points out the major questions involved in use of capitalized net operating income as an indication of value. In discussing the rate of capitalization he mentions 6% as the usual figure and indicates that a lower rate may be justified under depression conditions. By such reduction fluctuations are minimized and may result in pegging values at a figure on which the taxpayer can ill afford to pay.

Development of the basis of the rate presents an interesting problem. Since net operating income is computed before fixed charges, the use of current borrowing rates is not wholly proper for the basis of capitalization. No business can hope to survive if all its capital must be raised by borrowing at fixed rates with adequate underlying security. A fair and proper basis is the rate of return which new owners — stockholders — may demand. Our experience has indicated that eight to ten percent will prove attractive, and that six percent is a minimum.

Use of cost of reproduction less depreciation as a measure of value presents many controversial features. It assumes that the road and equipment will be reproduced item for item. This is not a fact. The use of depreciation only, as indicated by Mr. Chapman, fails to take into account age and obsolescence. These latter two factors may have more influence on value than current operating condition. A new building and a 50-year-old building, identical in physical construction, will not have the same value. It is obvious that outmoded and obsolete facilities will not be worth reproducing though they may be kept in relatively good operating condition. Provided a detailed examination is made to cover all features, reproduction cost less depreciation can be used as a check against other evidence with some degree of certainty.

Mr. Chapman does not go into detail about allocation factors, yet this subject is probably one of the most controversial features in the "system unit value" method of taxing railroads. Each basis he mentions is subject to some criticism. For instance:

Gross Operating Revenues show where business is done and, assuming relatively uniform earnings, where net should be earned. It does not show location of property and may fail to reflect accurately net results.

Net Operating Income shows where earnings are made but does not show location of property.

Mileage All Track must assume uniformity per mile to reflect accurately location of property and fails to show where earnings, gross or net, are earned.

Car and Locomotive Miles show the use of rolling stock but do not reflect the amount of business done or the line over which the miles are run. This factor is a very useful guide for assignment of equipment.

Revenue Traffic Units show the volume of business. Presumably the busier the line the higher the value. These statistics fail to disclose revenue, gross or net, or the amount of property necessary to produce the figures.

Physical Property shows the relative location of tangible property but fails to disclose earning capacity.

Assuming the same critical attitude towards allocation factors that Mr. Chapman has used towards the three indications of value, a basis can undoubtedly be developed which will produce a just result in each individual case.

The statistical information listed by Mr. Chapman is well calculated to throw light on the problem of taxable value and particularly on the relative tax burden of each railroad. Its use may develop facts which throw light on the results obtained by the primary data he has discussed.

Assuming lines of equal earning capacity, the one having the better road and equipment will be more valuable. Assuming lines identical in physical characteristics, the one having the higher earning capacity will be more valuable. In each case relationships are established. This is probably the fundamental difficulty in statistical appraisal. Relationships may be fixed with some degree of accuracy, but whether the results are or are not "Taxable Valuation" must be judged on the individual facts, the laws of the state in question and in the light of the general tax administrative policy of the state. Statistics and accounts are only the evidence which when analyzed and applied fairly and properly will probably result in a just determination of the share of ad valorem taxation to be borne by the taxpayer under discussion.

CHAIRMAN LELAND: I think we have a good start now. Mr. Karl Fischer, the tax attorney of the Chicago, Burlington & Quincy Railroad will continue the discussion.

K. W. FISCHER (Illinois): Gentlemen and Mr. Chairman: I am very much impressed with the opinions that have been stated by our administrative tax officers who are represented on this program. They have given us to assume, and I think rightfully so, that statistics after all are the measurement by which they conclude, with a reasonably honest judgment of the facts as they find them to be, the true value of a railroad property.

As I see it, no railroad tax officer should object to those theories when they are honestly pursued, but as Mr. Beckett more or less facetiously stated, a great many of them look at the last year's tax bill to determine what is the most logical thing to do for the current tax bill.

We are faced, truly, with an unfortunate situation, in that all taxing officials in states where the ad valorem basis is used, give more or less concern to what is the best arrangement of statistics to produce the largest valuation in their particular territory, with the obvious result that railroads generally, interstate railroads, are paying on an assessment in excess of any kind of a properly allocated value of property in these various states.

In making this statement, I am of course of the knowledge that my colleagues and myself are not entirely without sin. In our presentation of cases we lean more or less upon the most favorable factor in the states in which we are making the presentation of our arguments. That doesn't avail us anything, and I doubt whether there are any advantages in following that particular procedure. After all, the tax commissioners are getting pretty well acquainted with one another and they exchange the information that is used by each of us in the presentation of these states, and the sooner we wake up to the fact that that condition prevails, and have the same story for each state in which we make our presentation, I think the better off we will be.

I am very much interested in the statements made by both Mr. Mott and Mr. Faricy on the physical valuation of railroad property to be used as a tax base. I was rather surprised, as a matter of fact, to find Mr. Mott laying the stress upon using physical valuation in a small measure rather than in a controlling measure in finding the value of property for taxing purposes.

Mr. Faricy lays particular stress upon the inadvisability of doing that, which I am sure all of you fair-minded taxing officials will surely recognize. The fact remains that we have a property that is not based upon any sort of a physical value as of today. The property has an economic value which in lots of cases has little relationship to any of the physical values that may have been pre-

pared by the interstate commerce commission or the state officers themselves.

We must recognize that in its economic value, as Mr. Faricy set forth, we are not what we were originally termed—and as late as ten or fifteen years ago—a lone wolf in the transportation field: we had, outside of the seaport and river communicating towns, the sole transportation agencies. Today we have competition of all kinds and classes, which has very materially affected the value of our property. I think the economic value of the property is what you are looking for, not the physical value, and the physical value was built up at a time when such competition was not prevailing.

I will not take up any more of your time for fear the chairman will take advantage of his gavel and shut me off.

But the fact remains that what we want, what all railroads want, is a uniform system, all states to recognize the values as they have them in their states, not as necessity requires them to get revenue for various purposes and get it out of the railroads.

Political valuation of railroads is fast passing out of existence, and I want to compliment the Wisconsin commission for attempting to follow a scientific basis to find the tax upon which to judge the value of the property.

CHAIRMAN LELAND: That concludes our regular discussion of these papers and the subject is now open to discussion from the floor under the two-minute rule. Anyone can say anything about this subject that they want to, but they will be limited to two minutes.

W. E. KAY (Florida): I am a stranger at this meeting. I want to ask for light on the question of whether the rulings of the United States Supreme Court in the tax cases of the Great Northern and the Chicago Northwestern are considered mandatory or merely advisory to state taxing bodies?

CHAIRMAN LELAND: Professor Bonbright has asked for two minutes.

JAMES C. BONBRIGHT (New York): Thank you, Mr. Chairman. I beg your indulgence for a minute or two.

The point that I wanted to raise is a point implicit, I think, in Mr. Ford's statement, but so important that I believe it ought to be made explicit. That is, that the use of the unit rule cannot possibly result in the ascertainment of the true value of that part of the railroad which lies in any one state. The rule is good, but it is not applicable to that particular case. If you want to reach the true value of any part of an organic whole, you have to proceed on the assumption that the sum of the values of the parts does not equal the value of the whole. That is almost an economic axiom.

You can't find, by any process of allocating the system value of the Lackawanna Railroad, for example, what the Lackawanna properties in New Jersey are really worth by taking system value and by allocating to New Jersey some percentage and then allocating to Pennsylvania the remaining percentage after deducting that New Jersey percentage from 100. It won't work.

The value of the Lackawanna properties in New Jersey plus the value of the Lackawanna properties in Pennsylvania exceeds the value of the whole. So that it seems to me that discussions as to whether we should use mileage formulas, whether we should use traffic statistic formulae, and so on, discussions of that sort, are discussions *in vacuo*, if we assume that they are designed to determine the true value of the property.

The state of New Jersey, it seems to me, and not the railroads, is more nearly right in insisting that its method will get the true value of those properties in New Jersey. That is, that its method will come closer to determining how much the Lackawanna Railroad as a system would suffer were it to be bereft of its New Jersey properties.

It so happens that I don't like to use true value as a basis on which to evaluate any portion of an organic whole for tax purposes. But that is just a preference. That is a policy matter. The problem, then, of determining your proper allocation formula is not the problem of finding out what formula reaches some supposed objective, namely, what the properties are really worth; it is rather the problem of creation, the problem of deciding as a matter of good public policy whether people will be happier if you use a mileage formula or if you use some alternative formula.

CHAIRMAN LELAND: I will recognize next Judge Leser, our president.

PRESIDENT LESER: I want to apologize for intruding, but I haven't been off the tax commission long enough to lose interest even in this subject.

It so happens that before our commission we had the problem of valuing the right-of-way, not of a railroad in this instance, but of an electric transmission line. The underlying principle, of course, would be the same. I have listened here in vain for any discussion of the proper way of valuing rights-of-way, regardless of the structures on such rights-of-way. So with your indulgence, I would like to read to you two paragraphs from the ruling that my commission made in settling that question.

The argument had been made that this right-of-way consisted of a large series of small lots, mostly farm lots, which had been purchased at excessive, fancy prices, and there had been great expense incurred in assembling them, all these elements should be excluded,

and the right-of-way should be valued for taxation as if it were so many separate pieces of farm property. This was the answer of our commission.

"The question to be determined by this commission is not the fair market value of lots of land considered as separate parcels, but the value of such parcels after they have been gathered into a single hand and when their potential utility as a right-of-way for an electric transmission line, latent in them at the time of their purchase, became available and apparent. Prices paid for property which may be considered abnormally high under ordinary circumstances, and therefore as not reflecting the fair value of the individual parcels transferred, are not without significance in the consideration of the value of the right-of-way of which they are component parts, in view of the common knowledge that any purchaser of land for use as a similar right-of-way would, in the nature of things, likewise be subject to the same conditions and vicissitudes in the acquisition of contiguous parcels of land needed for the purpose."

CHAIRMAN LELAND: Your time is up, President Leser.

PRESIDENT LESER: I am only half through.

PHILIP ZOERCHER (Indiana): I move his time be extended.

(The motion was duly seconded)

CHAIRMAN LELAND: All in favor signify by saying, aye.

(Ayes)

CHAIRMAN LELAND: Opposed, no.

(None)

PRESIDENT LESER: If necessary, I will overrule the chairman.

Let me say here, in parentheses, that I have looked in vain in all kinds of publications for light on this subject. Really an intensive study was only made in connection with this case and it may possibly provoke discussion. If it does I am very glad.

"Though the income-producing quality of the project is an important element which would influence both seller and purchaser of the right-of-way in its completed state, in determining its fair exchangeable value in money, the commission has not been supplied by the petitioner with information bearing on the profitableness of the use of such right-of-way. In the absence of better or more complete evidence of value, it is not improper to assume that the original cost to the petitioner of the entire property composing the right-of-way, including all expenses incurred in its acquisition, may be considered as a factor affecting its value as a completed right-of-way; and that for the purpose of determining such cost consideration may properly be given to all expenses which are properly

or ordinarily incident to the acquisition of property for such purpose. Such expenses would include the cost of an aerial survey and the cost incurred in the selection of the route; sums paid to the right-of-way agents for their time and expenses; costs incurred for the examination of property titles and for recording deeds; payments to property owners for crop or other damage done in the construction of the transmission line; interest during construction."

W. E. KAY: May I ask whether the gentleman is discussing a rate or a tax basis?

PRESIDENT LESER: I am discussing a method of arriving at the valuation of right-of-way. If you have a better method, mister, let us know it.

CHAIRMAN LELAND: The chair will next recognize Mr. George G. Tunell, the tax commissioner of the Santa Fe Railroad, long a member of the association and dean of all the tax commissioners of railroads of the country.

It is a pleasure to have you.

GEORGE G. TUNELL (Illinois): First of all, I wish to thank you for your very flattering introduction.

It has seemed to me as I have listened to the papers this afternoon and the extempore statements, that anyone coming in for the first time to listen to discussions covering the assessment of railroads for taxation purposes might be quite bewildered by the many factors to be taken into consideration. They seem almost, as presented, to be insuperable. But I don't think they are.

First, we have the objective clearly set up in the laws of our states. The language used in the constitution of the state of Oklahoma, I think, is very fine. I am now speaking of the application, of course, of the general property tax. The constitution says that all property which may be taxed ad valorem shall be assessed for taxation at its fair cash value, estimated at the price it would bring at a fair voluntary sale. I ask you to note the word "estimated."

The supreme court of the United States has improved that objective, and it has gone farther and stated that the various terms used in the various state laws, fair cash value, market value, and so forth, all mean the same thing.

The supreme court has also said that in dealing with a matter as vast as the assessment of railroad property, and as extensive a system, there must be a procedure adopted.

The supreme court has also said that there are methods of valuation or procedures for gaining knowledge of what the property is worth, and it has said first of all that anything which throws light, any material fact, upon the objectives set up in the law, namely, the ascertainment of the fair cash value of the property, is pertinent, with all of which I agree.

The court has gone farther and has said that there are two methods which have importance above all other methods in the ascertainment of the value of most properties. The court, of course, refers to properties whose stocks and bonds are traded upon and properties that have a net railway operating income.

The court has never said just what emphasis should be placed upon one factor or the other, beyond stating that these two methods stand out, and where the facts are available, I agree heartily with the view of the court, that the stock and bond method and the capitalization of net income are the two most reliable methods reflecting the objective which we are seeking.

I do not say, and the court has never said, that the results reached by the mathematical operations indicate or state the objective. But in estimating the fair cash value of the property under consideration, for taxation purposes, these two factors, or these two procedures, are the best available.

If I may, I want to say just a word in regard to the use of cost of reproduction, less depreciation. I never speak of those results as values, because I distinguish between cost, or cost of reproduction, and value, by which I mean a price that may be obtained at a fair voluntary sale.

Two of the speakers, at least, of this afternoon have said that assessing officials have in mind the objective. They are much like we were when we were small boys. We made use of the answer in the arithmetic book in working back. I think cost of reproduction, less depreciation, is made use of in the same way. By taking ten per cent, or twenty per cent, or thirty per cent, most any result can be obtained that may be desired, cost of reproduction being so much greater than either the stock and bond value or the result found by the capitalization of net.

I have asked on more than one occasion for a statement of the logical relationship between cost of reproduction and value—shall ten per cent be taken if a composite figure is used, or twenty, or thirty, or forty?—and I don't get an answer.

I wish to say just a word about Mr. Mott and his work. We go over the data and we agree upon the procedure almost to the end. Then I am glad to say he has never asked me to accept his view of what should be done from that point on, and I have not asked him to abandon his views. We at this stage of the game try to reach a figure that will be acceptable to both of us, both of us disregarding procedure from a certain standpoint.

CHAIRMAN LELAND: In view of what has been said as to cost of reproduction and other things, I think at this juncture it would be well for you to hear the statement that Commissioner J. H. Thayer Martin, tax commissioner of New Jersey, left with reference to

Mr. Mott's paper. It is written out here and will come within the two-minute rule.

"I assent to most of Mr. Mott's conclusions. From the point of view of New Jersey, a few of them should be emphasized. The situation in New Jersey is peculiar in that three-quarters of the tangible property of the railroads is concentrated on the New York waterfront, where it is all exceedingly valuable real estate, and as such would be readily saleable for other uses, and that property we believe we have valued at not more than it could be sold for.

"The remaining lands of the railroads, (mostly their main lines) we also try to value at not more than they could be sold for. Most of them could be taken over for express highways for auto traffic, and we believe our valuations do not exceed what the state would and should pay on condemnation for that purpose. Under such circumstances we believe all that real estate has for tax purposes at least the same value that we think we can prove it could be sold for. We do not believe it loses that value just because the owners are now using it for a purpose where it does not now bring in a revenue commensurate with its true value.

"Also, New Jersey feels it cannot adopt any 'system value' for tax purposes, because even if a real system value could be agreed upon, no method of allocation has yet been suggested which fairly recognizes the extremely large 'market value' and therefore taxable value of these New York waterfront terminals.

"Of course, the method of valuation we use requires as a corollary an equalization of the valuation of other property as it affects the tax rates. This in New Jersey is committed to the state board of tax appeals, not to the tax department."

Is there further discussion of these papers?

PHILIP ZOERCHER (Indiana): I move we adjourn.

CHAIRMAN LELAND: I will recognize Mr. Arnovitz.

I am slightly deaf, Judge Zoercher. I will hear you within the next two minutes.

IRWIN ARNOVITZ (Utah): I just have this observation to make. The statement has been made here, and I take it it is almost universally accepted, that all that a given parcel of utility property is worth is that amount which it will produce a reasonable return upon. I am wondering whether that same rule or that same measure should not be applied to the valuation of a related piece of utility property or railroad property, namely, car companies? I notice that that problem is treated differently in different states, and some of you have, of course, your gross proceeds method of valuing property.

But we are often told by the same tax agents who represent a railroad that we should take into account the earnings of the rail-

road but that when we are considering the valuation of a car company we ought not take into account the earnings.

I leave that matter with this conference, particularly in view of the fact that we found in the case of some of the railroads they have found it to their advantage to divorce from the railroad operation the operations of the car company, and it becomes important because it so happens that in the operation of the car company, you very frequently get a rate of return way out of proportion—sometimes as high as a fifty or fifty-five per cent rate of return—to what one would expect in the return of property.

So I am wondering whether it isn't also fair to apply that same measure to the valuation of car companies as to the valuation of the railroad company itself? If someone has any observations to make, I would certainly be pleased to hear them.

M. M. DAUGHERTY (Delaware): It seems to me it is feasible to value a car company and a railroad company differently, because a railroad company is made up of irreproducible property, and property that was not reproduced within the last couple of decades, at least, and the property of a car company is made up of personal property that is reproduced every day. It is really competitive business, or very much more so than a railroad company.

It seems to me, in fact, that the whole basis of the use of cost values and so on is predicated on the theory that those figures represent the amount that the property could be sold for.

Now, the earnings of a railroad and the earnings of a car company are entirely different things.

One more observation. A gentleman up here spoke of the mixture of eggs to make an omelet—the addition of a rotten egg in an omelet to the other items. Let us not use the word “rotten,” but maybe a different one. Most of us have different tastes as to omelets, and we will put in one that will suit our taste better than it will suit, maybe, our guest's taste.

We say that sound, honest and mature judgment is better than figures. Isn't that patting ourselves on the back a lot, to say that we have sound, honest and mature judgment? If we have that, why do we want to get up all these figures and go through all these statistics? We say that by the use of judgment we can get a value that is more in conformity with the facts in the case. What are the facts in the case? Do we want to set up a value of railroads that is bigger, or more uniform, or what is it we are wanting? I don't know, and I have listened in vain to find out.

It seems to me that if we are going to use the earning value of a railroad, then we might as well figure that we are using an income tax on the railroad, which is not contemplated.

CHAIRMAN LELAND: There will be another session this evening at eight o'clock and there will be another meeting of this conference next year. We can pick up some of these points that are lively issues here and perhaps carry them forward.

Mr. Holcomb asked me to announce that he would like to have a meeting of the nominations committee as soon as this meeting can be adjourned. This committee consists of all the past-presidents of the association, of which the following are here: Messrs. Lutz, Fairchild, Zoercher, Edmonds, Long and Graves; and Messrs. Lamb, Knapp and Brown representing the association at large.

I will declare this meeting adjourned, and I want to thank you all for your tolerance and patience.

NINTH SESSION

WEDNESDAY, OCTOBER 27, 1937, 8:00 P. M.

PRESIDENT LESER: The meeting will come to order.

Before presenting the presiding officer, I would like to announce that through an unavoidable circumstance Mr. Tobie, whom I had designated as chairman of the resolutions committee, was obliged to leave the city, and I have therefore prevailed on Mr. Maxwell, commissioner of revenue of North Carolina, to function in that position.

I don't want people to get Tobie, sometimes spoken of as "to be or not to be," mixed up with Tobin, because I just told you Tobie wouldn't be here and I am going to tell you right now Tobin will be here and is going to preside over you and keep you in order.

Mr. Tobin, of Albany, New York, former counsel of the state tax commission.

CHARLES J. TOBIN, presiding.

CHAIRMAN TOBIN: The secretary has some announcements to make first, which we shall have at this time.

SECRETARY W. G. QUERY: Judge Leser announced the appointment of the chairman of the resolutions committee, but he didn't tell you that he had also appointed the member of the resolutions committee from those states that had not reported. He left that for me to do.

Judge Leser has appointed J. L. Holcombe, Delaware; M. M. Sims, Georgia; Louis E. Roddewig, Iowa; James W. Martin, Kentucky; F. W. Raggio, Louisiana; Harry O. Levin, Maryland; M. B. McPherson, Michigan; A. H. Stone, Mississippi; John R. Spring, New Hampshire; J. Lindsay DeValliere, New Jersey; Seth T. Cole, New York; A. J. Maxwell, North Carolina; J. H. Bottum, South Dakota; Irwin Arnovitz, Utah; C. H. Morrisett, Virginia; Paul N. Reynolds, Wisconsin; W. J. Dalton, Wyoming; to serve with the delegates appointed by the state delegations as members of the resolutions committee.

It might be well for me to repeat the appointments that were made by the delegations: Messrs. Curry, Ellsworth, Hetherington, Hackett, Littlepage, Ramsey, Terry, Geoffroy, Boyle, Evans, Smith, Luchini, Wilkins, Cund, McKay, Leahy, Bradley, Bates, and Cooper.

Mr. Maxwell requested me to announce for him that the resolutions committee as just announced will meet in one of the parlors to my left immediately at the close of this session. Mr. Holcomb

also asked me to request the members of the nominations committee to meet with him in the next few minutes.

Now, Mr. Chairman, I have two resolutions I think I had better read and turn over to the resolutions committee.

"WHEREAS during the pioneer days of the nineteenth century when the people gradually moved westward from the thirteen original colonies under slow methods of transportation and communication, and when the nation's wealth was represented almost entirely by land, there was established a system of local county government based on what was deemed to be the most desirable features of the government of their forefathers in England and a similar system of taxation, based and dependent almost entirely on a tax on property, and

"WHEREAS with the vast extension of the services rendered by government during the latter part of the nineteenth and early part of the twentieth century these countries were further subdivided into municipalities, townships, school districts, road and bridge districts, drainage or irrigation districts, and various other subdivisions, all carrying authority to levy taxes on property or incur debt, resulting in the existence in the United States today of approximately 182,651 conflicting overlapping units of government with power to levy taxes on property as the basic source of revenue for their existence, or approximately one unit for each 650 people in the United States, and

"WHEREAS with the further extension of the services of government and the resultant vast increase in the total cost of government, federal, state, and local, from 1912 to the present date, of approximately 450 per cent—equivalent to approximately 330 per cent per capita—there have been levied, without any definite system or plan, a variety of special types of taxes with special provisions for their collection through thousands of new boards, commissions, and bureaus, thereby resulting in further overlapping and conflicting authority in the collection of revenue and general administration of the tax system, and conflict and duplication by the federal, state, and local government as to sources of revenue, and

"WHEREAS the increase in the total cost of government having been far in excess of the increase in revenue from new sources of taxation, together with the fact that the property tax has remained as the only tax based on capital value, without regard to income or use value, and on which these 182,651 overlapping tax-levying units have supreme authority to levy taxes without limit, the tax on property has long since reached the point of confiscation in many cases and the property tax system is, therefore, rapidly breaking down under its own weight, and property is being vastly overtaxed in proportion

to the benefits received from government, which condition is definitely depressing the economic condition of the nation;

"NOW, THEREFORE, BE IT RESOLVED by the thirtieth annual conference at Baltimore, Maryland, that this conference sponsor, in the interest of equity, efficiency, and the general welfare of the nation, a modernization and revision of the tax structure throughout the nation along the following general lines:

"1. The segregation of specified and sufficient sources of revenue to the federal government and thereby prevent the overlapping and duplication of the federal and state governments as to sources of revenue thus preventing excessive levies, overlapping authority and consequent excessive administration cost.

"2. The consolidation of tax collecting authority in the various states and local units of government into well organized and efficient departments for greater economy of administration and more uniform and equitable enforcement of tax collection laws.

"3. Consolidation or elimination of many of our 182,651 conflicting overlapping tax-levying units of government and the drastic restriction of the tax-levying authority of the remaining local units of government by prohibiting the levy of a tax on real property on the basis of its capital value or assessed capital value, and the substitution of a system of taxation on property, based on rent or rental value, or other similar system of property taxation by which property will be taxed on the basis of its revenue producing value and cannot be confiscated as result of overtaxation through the continuation of the tax-levying powers of an excessive number of local overlapping unsupervised units of government."

Another resolution:

"RESOLVED, that this conference recommends the repeal of the undistributed profits tax in its present form, but if practical considerations for government finance make immediate repeal impossible, at least the following changes should be made in the undistributed profits tax law:

"1. The actual income and not taxable income should be made the basis of the tax, and therefore actual net profits after allowing all legitimate costs and losses including those of a capital nature should be subjected to the dividends pressure.

"2. To remove the tax duplication as it now exists, a credit to stockholders be allowed for corporate profits distributed which, prior to the distribution, were subject to normal and surtaxes in the hands of the corporation.

"3. A reasonable amount of earnings, either a statutory percentage or a fixed amount, be allowed each corporation before the undistributed profits is calculated.

"4. Since it is obviously impossible for business to determine and physically distribute its year's earnings before that very year is over, that a reasonable time be allowed for such distribution providing it is made before the filing of the return for that year involved.

"5. That even a regimented economy has not succeeded in eliminating the peaks and valleys of business profits and losses, and because of this the two-year carry forward of losses provision be restored to the law, particularly when such high business tax rates as we have today are part of the general taxing statutes."

CHAIRMAN TOBIN: Mr. President, Delegates, Ladies and Gentlemen: The National Tax Association, the sponsor of these conferences, has, through its program committee, given us a well-balanced program, and we should stop here for just a moment and express our thanks for the excellent program that has been given us for these various sessions and also for the competent and well-informed persons who have been chosen to discuss these particular subjects as we have moved on.

In the seventh session there was taken up for your benefit and discussion the laws of 1937, those new laws on the subject of taxation. Tonight we move, as a part of this well-balanced program, into the court interpretations as they have affected tax laws, and various changes that have come about in the past year.

The answer to all this has been a large attendance—in fact, a larger attendance at our sessions than ever before, and a more acute attention to the papers that have been read and the discussions that we have had.

Tonight we have as our first speaker on the program Thomas C. Lavery, of the College of Law, University of Cincinnati, who will address you on the recent court decisions.

With great pleasure I introduce to you Mr. Lavery.

THOMAS C. LAVERY (Ohio): Mr. President, Mr. Chairman, Ladies and Gentlemen of the Conference: The task of summarizing the forty-five cases out of the one hundred and sixty-three cases which were decided by the supreme court during the October, 1936, term turned out to be quite a job.

Shakespeare in one of his plays in referring to a formation of words calls them a vile phrase. My first paragraph, as many of you who took copies of it must have noticed, in this paper is a vile paragraph. Out of the forty-five cases that touched on some phase of federal-state taxation, I disposed of twenty-five in that paragraph and almost all of them in one sentence.

The reason I did it that way was because I have only a limited number of suitable verbs in my vocabulary with which to start off a sentence introducing these cases. So I thought it would be better to use one verb and follow with a lot of phrases strung together with semicolons than it would to try to find a new verb to fit each sentence.

Those twenty-five cases are important cases. As I have said, their importance is shown by the fact that the supreme court heard them, cited them, and wrote opinions on them. But they do not, in my opinion, indicate trends in taxation, and hence it seems to me that we can very well dismiss them without prejudice from this discussion.

With twenty cases left to discuss, I again had to do some eliminating. Professor Powell will take up one of the cases that I am going to eliminate, and perhaps others. The case in which our distinguished friend, Mr. Long, was a party, *Binney against Long*, I am going to dismiss for the reason that after I arrived here he told me he didn't know what it was about, and I came with the belief that I didn't know what it was about, and I thought if I tried to tell you what it was about you wouldn't know what it was about. It is a good case. As Justice Holmes once said, "These are the cases. They can be read."

TAXATION IN THE SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1936

THOMAS C. LAVERY

College of Law, University of Cincinnati

During the October 1936 term of the supreme court of the United States opinions were written in one hundred and sixty-three cases, of which forty-five touched some phase of the law of federal or state taxation. Of these some are not of sufficient moment to justify more than casual comment in a conference of experts such as this. There can be little more than a flutter of technical interest in the fate of the Iowa chain store tax act, imposing a tax based on gross receipts from sales according to an accumulative graduated scale, held invalid in *Valentine et al. v. Great Atlantic & Pacific Tea Company*, 299 U. S. 32, 57 S. Ct. 56, 81 L. Ed. 25 (1936), as creating arbitrary discrimination similar to that condemned during the October 1934 term; in *Stewart Dry Goods Company v. Lewis*, 294 U. S. 550, 55 S. Ct. 525, 79 L. Ed. 1054 (1935), under the equal protection clause of the fourteenth amendment; in a state's claim to priority over a city's claim for taxes, denied in *State of Missouri v. Ross, et al.*, 299 U. S. 72, 57 S. Ct. 60, 81 L. Ed. 6 (1936); in the construction of the phrase "required by law," as used in the Revenue Act of 1928 in connection with reserves permitted to be de-

ducted by insurance companies in computing their net income, interpreted in *Helvering v. Illinois Life Insurance Company*, 299 U. S. 88, 57 S. Ct. 63, 81 L. Ed. 42 (1936); in a conviction for conducting the business of wholesale liquor dealer without having paid the special tax imposed by federal revenue laws, through a misconception of the nature of the exaction and a disregard of Justice Holmes' dictum that "congress may tax what it also forbids," sustained in *Wainer, et al. v. United States*, 299 U. S. 92, 57 S. Ct. 79, 81 L. Ed. 57 (1936); in the jurisdiction of a federal court to entertain suit against one national bank which had assumed liabilities of another to recover state taxes on shares for which the latter was liable as stockholder's agent, asserted on the theory that the state tax was void unless permitted by federal law, a theory characterized as doubtful and conjectural by the court in denying federal jurisdiction in *Gully v. First National Bank of Meridian*, 299 U. S. 109, 57 S. Ct. 96, 81 L. Ed. 44 (1936); in the validity of Montana's gross production tax as applied to a lease of lands in the Blackfeet Reservation, sustained in *British-American Oil Producing Company v. Board of Equalization of the State of Montana*, 299 U. S. 159, 57 S. Ct. 132, 81 L. Ed. 92 (1936); in who is a "dealer in securities" within the meaning of that phrase as used in the Revenue Act of 1928, entitled to take inventory at cost or market, whichever was lower, construed by the court in *Helvering v. Fried*, 299 U. S. 175, 57 S. Ct. 150, 81 L. Ed. 114 (1936), to include brokers who as merchants bought and sold securities to customers for profit, and in *Schafer v. Helvering*, 299 U. S. 171, 57 S. Ct. 148, 81 L. Ed. 112 (1936), to exclude brokers who bought and sold on their own account for purposes of speculation; in the reversal of a judgment of a circuit court of appeals for invading the function of the United States Board of Tax Appeals by weighing evidence and fixing the March 1, 1913 value of cemetery lots, where substantial evidence supported the conclusion reached by the board, in *Elmhurst Cemetery Company of Joliet v. Commissioner of Internal Revenue*, 300 U. S. 37, 57 S. Ct. 324, 81 L. Ed. 298 (1937); in the validity of an Oklahoma ad valorem tax applied without discrimination to property used in the production of oil and gas under a leasehold of restricted Pawnee lands, sustained in *Taber v. Indian Territory Illuminating Company*, 300 U. S. 1, 57 S. Ct. 334, 81 L. Ed. 368 (1937); in the applicability of the stamp tax provisions of the Revenue Act of 1926 to transfers by one broker of a customer's account to another broker through the cotton exchange by delivery of "bought and sold memoranda" without charge for commissions, sustained in *Dupont v. United States*, 300 U. S. 150, 57 S. Ct. 391, 81 L. Ed. 304 (1937), as an excise upon the privilege, opportunity, or facility offered at exchanges for the transaction of business and not upon the business transacted; in the limitation upon state taxing power

as applied to bank credits created by the deposit of incompetent world war veterans' compensation imposed upon the admitted power of congress to safeguard payments made by it for the maintenance and support of disabled soldiers, broadened in *Lawrence v. Shaw*, 300 U. S. 245, 57 U. S. 443, 81 L. Ed. 391 (1937), so as to dispose of the question left open by the court in *Trotter v. Tennessee*, 290 U. S. 354, 54 S. Ct. 138, 78 L. Ed. 358 (1933); in whether a transaction in which one entitled to receive stock directed the corporation to issue the certificates for his convenience to a nominee who received no beneficial interest therein, involves a transfer by the beneficial owner requiring a documentary stamp pursuant to the provisions of the Revenue Act of 1926, held taxable in *Founders General Corporation v. Hoey*, 300 U. S. 268, 57 S. Ct. 457, 81 L. Ed. 435 (1937); in the claim of the United States for interest on an alleged additional assessment of income and excess profits taxes for which no demand had been made and asserted by counterclaim in the taxpayer's suit on a government contract in the court of claims, denied in *American Propeller & Manufacturing Company v. United States*, 300 U. S. 475, 57 S. Ct. 521, 81 L. Ed. 543 (1937); in the doctrine that the power of congress to lay taxes upon subjects within the constitutional range of selection is unaffected by the fact that the impact of the tax has a regulatory effect, reaffirmed in *Sonzinsky v. United States*, 300 U. S. 506, 57 S. Ct. 554, 81 L. Ed. 556 (1937), sustaining the National Firearms Act; in the intricacies of the recognition-of-gain-or-loss provisions of the Revenue Act of 1918, applied in *Helvering v. Tex-Penn Oil Company*, 300 U. S. 481, 57 S. Ct. 569, 81 L. Ed. 534 (1937), to a corporate reorganization; in the scope of the power of courts to review the determination of the commission in cases of special assessment of excess-profits taxes, limited in *Welch v. Obispo Oil Company*, U. S. 57 S. Ct. 684, 81 L. Ed. 693 (1937); in the denial of immunity from state taxation under the commerce clause to a foreign pipe line company whose activities transcended the practical conception of interstate commerce drawn from the course of business by the gradual process of judicial inclusion and exclusion, found in *Southern Natural Gas Corporation, et al. v. State of Alabama*, — U. S. —, 57 S. Ct. 696, 81 L. Ed. 605 (1937); in the question of what does or does not constitute an association within the purview of the provisions of the Revenue Act of 1928 providing for a tax upon associations as corporations, examined with careful attention to detail in *A. A. Lewis & Company v. Commissioners of Internal Revenue*, — U. S. —, 57 S. Ct. 799, 81 L. Ed. 748 (1937); in the broad construction of the words of the Revenue Act of 1928 permitting deductions of charitable contributions by trust estate to the full extent of their gross income, viewed with favor in *Old Colony Trust Company v. Commissioner of Internal Revenue*, — U. S. —, 57 S. Ct. 813, 81

L. Ed. 732 (1937); in the denial of equal protection by Georgia in permitting mutual insurance companies to act through salaried resident employees, but excluding stock companies from the same privilege, recognized by the court in *Hartford Steam Boiler Inspection & Insurance Company, et al. v. Harrison*, — U. S. —, 57 S. Ct. 838, 81 L. Ed. 857 (1937); in the effort of trustees to recover income taxes erroneously paid upon trust income properly payable by the beneficiaries except for the bar of the statute of limitations, whether in form an action to recover the tax, the lineal successor to the common count *in indebitatus assumpsit* for money had and received or by the extraordinary remedy of mandamus, denied respectively in *Stone et al. v. White*, — U. S. —, 57 S. Ct. 851, 81 L. Ed. 850 (1937), and *United States ex rel. Girard Trust Company v. Helvering*, — U. S. —, 57 S. Ct. 855, 81 L. Ed. 854 (1937); and in the effect of an assignment of an oil and gas lease upon the duty of the assignees to include in their gross income payments made directly to the assignors, held not taxable to the assignee in *Thomas v. Perkins et ux.*, — U. S. —, 57 S. Ct. 911, 81 L. Ed. 870 (1937). That these cases were important needs no proof other than the fact that the court heard and decided them. They do not, however, indicate trends which may influence the development of the law of taxation of the future; and they have, therefore, been dismissed, without prejudice, from further discussion.

(1) INTERGOVERNMENTAL RELATIONS

A phase of the problem of intergovernmental relations was involved in the cases of *People ex rel. Rogers v. Graves*, 299 U. S. 401, 57 S. Ct. 269, 81 L. Ed. 202 (1937), and *Brush v. Commissioner of Internal Revenue*, 300 U. S. 352, 57 S. Ct. 495, 81 L. Ed. 443 (1937). In the first, the general counsel of the Panama Railroad, a New York corporation entirely owned by the United States, brought a proceeding to contest the validity of a New York income tax laid upon his salary. The Panama Railroad operates a steamship line to the Canal Zone, a railroad, and many other economic enterprises there for the use of both government employees and the public. It is administered as an adjunct of the Panama Canal through officials elected by the secretary of war. The New York Court of Appeals affirmed an order of the appellate division upholding the tax on the ground that the railroad was a proprietary enterprise of the United States, and the taxpayer appealed. Taking the view that the administration of the railroad, being incidental to the operation of the Panama Canal under the war and commerce powers, was a governmental function, the court reversed the judgment rendered in New York.

In the *Brush* case, the chief engineer of the bureau of water supply of the city of New York brought a proceeding to contest

the validity of a federal income tax laid upon his salary. The circuit court of appeals for the second circuit upheld the tax, but upon certiorari, its judgment was reversed on the ground that the operation of the city's water system was an essential governmental function. Justices Stone and Cardozo concurred in the result; Justices Roberts and Brandeis dissented.

It is conceivable that a different result might have been reached in both cases upon the authority of *Helvering v. Powers*, 293 U. S. 214, 55 S. Ct. 171, 79 L. Ed. 291 (1934), where the income of a state-appointed trustee of the Boston Elevated Railway was held subject to federal income taxation. The theory of the Rogers case seems to be that enterprises constitutionally undertaken by the United States are necessarily governmental and, therefore, immune from state taxation. On the other hand, only some state enterprises are immune—those which are comprised in essential and proper functions of government. With the ever-increasing extension of government into fields traditionally of a private nature, exceptions might well be made in the doctrine of reciprocal immunity of state and federal instrumentalities. There could be as much truth as poetry in Justice Holmes' aphorism that "the power to tax is not the power to destroy while this court sits." In the light of what was said in the case of *Young's Market* with respect to the effect of the twenty-first amendment, a re-examination of the *Brushaber* case (*Brushaber v. Union Pacific Railroad Company*, 240 U. S. 1, 36 S. Ct. 236, 60 L. Ed. 493 (1916)), in the light of the plain language of the sixteenth amendment might be in order. On the record, however, the doctrine of *McCulloch v. Maryland*, 4 Wheaton 316, 4 L. Ed. 579 (1819) goes marching on!

In a test case to recover excise taxes paid by a tobacco manufacturer who sold some of its product to the commonwealth of Massachusetts for distribution without charge to patients in the Boston State Hospital, the court held in *Liggett & Myers Tobacco Company v. United States*, 299 U. S. 383, 57 S. Ct. 239, 81 L. Ed. 215 (1936), that there should be no recovery on the ground that the tax, being upon manufacture, had at most merely an indirect effect upon the purchaser and, therefore, imposed no prohibited burden. Support for this conclusion was found in the fact that the amount of the tax was in no way dependent upon the intrinsic value of the tobacco nor upon the price obtained upon its sale. Counsel for the commonwealth had relied upon the principle of the *Panhandle*, *Motorcycle*, and *Graves* cases, but the court thought that the character of the tax as an excise on manufacture was clearly disclosed by the administrative provisions of the taxing act, strengthened by the provisions of the treasury regulations designed to carry the intent of congress into effect; and that the significance of such factors as the time of accrual of the tax and the method of its collec-

tion was exhausted in mitigating its burden. The court, in thus choosing a line of cases under which the tax could be sustained, seems to have been influenced partly by the necessity of effectuating, if possible, the will of congress, and partly by the desire to leave unrestricted a traditional source of federal revenue.

(2) FEDERAL POWER

The scope of the federal taxing power in relation to the Philippine Islands was considered in *Cincinnati Soap Company v. United States*, — U. S. —, 57 S. Ct. 764, 81 L. Ed. 707 (1937). The question involved was the validity of an act of congress which imposed a tax upon the first domestic processing of cocoanut oil and provided that all such taxes collected with respect to the cocoanut oil wholly of Philippine production should be held as a separate fund and paid to the treasurer of the islands, except that should the Philippine government at any time provide by law for a subsidy to be paid to the producers of cocoanut oil or allied products, then no further payments to the Philippine treasury should be made.

Petitioners were engaged in manufacturing soap and used large quantities of cocoanut oil, wholly the product of the Philippine Islands. The validity of the tax was assailed on the following grounds:

That the tax was not imposed for any purpose contemplated by the taxing clause of section 8, article 1, of the federal constitution, but on the contrary was imposed for a purely local purpose, in violation of the tenth amendment;

That the exaction violated the due process clause of the fifth amendment because it was an arbitrary exaction from one group of persons for the exclusive benefit of another;

That the act did not impose a true tax but was a regulatory measure outside the field of federal power;

That it violated section 7, paragraph 9, of article 1, of the constitution, which provides that "No money shall be drawn from the treasury, but in consequence of appropriation made by law"; and

That the payment in bulk of the entire proceeds of the tax to the Philippines, with no direction as to the expenditure thereof, constituted an unlawful delegation of legislative power.

The court sustained the tax and answered the objections of the petitioners as follows:

(1) The tax was an excise on a manufacturing process for revenue purposes, and was in no sense a regulation of the process itself. In differentiating the tax in this case from that sought to be imposed in *United States v. Butler*, 297 U. S. 1, 56 S. Ct. 312, 80 L. Ed. 477 (1936), and in the Child Labor Tax Case (*Bailey v. Drexel Furniture Company*, 259 U. S. 20, 42 S. Ct. 449, 66 L. Ed. 817

(1922), the court pointed out that the exaction here, both in form and substance, was a true tax, imposed for a federal constitutional purpose; and, therefore, did not involve the due process clause of the fifth amendment.

(2) The objection as to the form, in which the appropriation of the proceeds was made was immaterial, provided the purpose specified was one for which congress could make an appropriation. On this point the court inquired as to whether the proposed appropriation the the Philippine treasury was for a constitutional purpose; and found that the political relation between the islands and the United States was such as to require the discharge by congress of its moral obligation to protect, defend, and provide for the general welfare of the inhabitants of the islands, this obligation falling fairly within the term "debts" as used in the taxing clause and as expounded in *United States v. Realty Company*, 163 U. S. 427, 16 S. Ct. 1120, 41 L. Ed. 215 (1896). The court further said that the determination of congress to recognize the moral obligation of the nation to make an appropriation, as a requirement of justice and honor, was obviously a matter of policy and discretion, not open to judicial review under the circumstances of the case.

(3) The court reviewed the circumstances leading up to the acquisition of the Philippine Islands under the war power and found that notwithstanding the recent legislation relating to Philippine independence, the moral responsibility of the United States to protect certain industries, both in the Philippines and in this country, could be discharged only by the exertion of congress of its power to levy a tax akin to its power to protect industries of the United States by a protective tariff.

(4) The contention that there had been no constitutional appropriation or any attempt to make an appropriation was deemed without merit because congress might still make an appropriation whenever it saw fit so to do.

(5) Finally, the court denied the contention that the act constituted an unlawful delegation of legislative power since congress when dealing with a dependency possessed legislative discretion, not subject to judicial review, sufficiently comprehensive to satisfy its needs.

(3) FEDERAL INCOME TAXATION

In *Helvering v. Midland Mutual Life Ins. Co.*, — U. S. —, 57 S. Ct. 423, 81 L. Ed. 375 (1937), the question presented was whether or not the insurance company had derived income from the foreclosure of mortgages on real estate given to secure loans which were in default, where it was the only bidder, its bid was accepted, the property was conveyed to it; where there was no redemption; where the bid included interest as well as the principal; and where in each case the fair market value of the properties was, at the

dates of foreclosure and of acquiring title, less than the amount of the principal due on the mortgages.

The company kept its books on a calendar year cash-receipts-and-disbursements basis, entering only payments of interest actually made to it during the year. Upon its acquiring title to the foreclosed properties, the investments were transferred on its books from the mortgage loan account to the real estate account and were carried thereon as assets at amounts which were equal to the principal of the loans secured by the mortgages plus any disbursements made for taxes, court costs, attorneys' fees or insurance premiums. The amount of interest included in the bids on foreclosure was not carried on the books as part of the cost of the properties or as an asset, nor was it entered on the books or otherwise treated as income. Four contentions were made by the taxpayer: first, that it did not "receive" any accrued interest either in cash or in property and, hence, that the amount thereof was not "gross income"; second, that since the evidence showed the fair market value of the mortgaged properties to have been less than the principal of the debts, the interest paid was not income within the meaning of the income tax act; third, that to regard as income under the circumstances the unpaid accrued interest would be to disregard the realities of the situation; and fourth, that to tax the mortgagee as upon interest received under the circumstances was inconsistent with the rule declared in *Louisville Joint Stock Land Bank v. Radford*, 295 U. S. 555, 55 S. Ct. 854, 79 L. Ed. 1593 (1935), that the mortgagee is entitled to have the "mortgaged property devoted primarily to the satisfaction of the debt, either through receipts of the proceeds of a fair competitive sale or by taking the property itself." The court found for the commissioner, thereby reversing the circuit court of appeals for the sixth circuit, which had in turn reversed the decision of the board sustaining the determination of the commissioner.

With reference to the taxpayer's contentions the court held that the effect of the taxpayer's bid, which included principal and accrued interest, was to discharge both the indebtedness and the interest by means of a credit; that the receipt of interest, whether paid in cash or by a credit, came within the intent of congress in its definition of the term "interest" as employed in the revenue act; and that where the intent to use the full extent of power was clearly evident, the court must not confine the legislation within narrower forms than the statutory language would indicate.

With reference to the contention concerning the realities of the situation, the court found that the reality of the deal involved was that the respondent valued the protection of the higher redemption price as worth the discharge of the interest debt for which it might have obtained judgment, and in any event it found nothing un-

familiar in taxing on the basis of the legal effect of the transaction, since income may be realized upon a change in the nature of legal rights held, though the particular taxpayer has enjoyed no addition to his economic worth. As to the last contention, the court replied that since the taxpayer had chosen to bid the full amount of principal and interest upon the foreclosure sale, thus obtaining, in legal contemplation, full payment of the interest as well as the principal, the charge of inconsistency with the case cited was unfounded.

(4) FEDERAL PROCEDURE—INCOME TAXATION

An interesting study in procedure is presented by *Blair v. Commissioner of Internal Revenue*, 300 U. S. 5, 57 S. Ct. 330, 81 L. Ed. 265 (1937), where the question was as to the liability of a beneficiary of a testamentary trust for a tax upon the income which he had assigned to his children prior to the tax years and which the trustees had accordingly paid to them.

In 1923 Edward Blair assigned to his children a part of his equitable interest in a trust of Illinois property created by the will of his father in 1899. A question arose with respect to the income tax for 1923, and the commissioner ruled that the income was taxable to the petitioner. The board of tax appeals held to the contrary. (18 B. T. A. 69.) The circuit court of appeals reversed the board, holding that under the law of Illinois the trust was a spendthrift trust and the assignments were invalid. (*Commissioner v. Blair*, 60 F. (2d) 340.) The court denied certiorari. 288 U. S. 602, 53 S. Ct. 386, 77 L. Ed. 977. Thereupon the trustees brought suit in the superior court of Cook County, Illinois, to obtain a construction of the will with respect to the power of the beneficiary of the trust to assign a part of his equitable interest and to determine the validity of the assignments he had made. Petitioner and the assignees were made defendants. The Appellate Court of Illinois, First District, after a review of the Illinois decisions, decided that the trust was not a spendthrift trust and upheld the assignment (*Blair v. Linn*, 274 Ill. App. 23); and under its mandate the lower court entered its decree which found the assignments to be "voluntary assignments of a part of the interest of said Edward Tyler Blair in said trust estate" and as such adjudged them to be valid.

At that time there were pending before the board of tax appeals proceedings involving the income of the trust for the years 1924, 1925, 1926, and 1929. When these appeals were heard the board received in evidence the record in the suit in the state court and, applying the decision of that court, overruled the commissioner's determination as to the petitioner's liability. (31 B. T. A. 1192.) The circuit court of appeals again reversed the board on the ground that the petitioner's interest had not attached to the corpus of the estate and that the income was not subject to his disposition until

he received it, although the court recognized the binding effect of the decision of the state court as to the validity of the assignments. (*Commissioner v. Blair*, 83 F. (2d) 655.) Because of an asserted conflict with a decision of the state court and also with decisions of circuit courts of appeals, certiorari was granted. (299 U. S. 543, 57 S. Ct. 33, 81 L. Ed. — (1936).)

In its opinion three points were discussed by the court: first, whether the judgment relating to the income for 1923 was conclusive in the present proceeding as *res judicata*; second, whether the question of the validity of the assignments was a question of local law; and third, whether, treating the assignments as valid, the assignor was still taxable upon the income under the federal income tax act.

With reference to the first point, the court found that in so far as the local law was determinative of any material point in controversy, the supervening decision of the state court interpreting that law could not justly be ignored.

On the second point, the court held that the question of the validity of the assignments was governed by local law, inasmuch as the donor was a resident of Illinois and his disposition of property in that state was subject to its law. By that law the character of the trust, the nature and extent of the interest of the beneficiary, and the power of the beneficiary to assign that interest in whole or in part was to be determined, and the decision of the state court on those questions was final, even though that decision might be rendered by an intermediate appellate court. Accordingly, the court found it unnecessary to go beyond the point that the decision was in a suit between the trustees and the beneficiary and his assignees, and the decree which was entered in pursuance of the decision determined as between these parties the validity of the particular assignments. There was no basis for a charge that the suit was collusive, the trustees being entitled to seek the instructions of the court having supervision of the trust. The court, therefore, held that it was not open to the government to argue that the trust was, under the Illinois law, a spendthrift trust, where the state court had held precisely to the contrary; and, further, that its ruling determined the validity of the assignment by the beneficiary of parts of his interest.

On the point as to the taxability of the income derived from the trust by the assignor, under the federal income tax act, treating the assignments as valid, the court held that where under local law there is a transfer of the beneficial interest under a trust, in whole or in part, without reservation, the assignee becomes the owner of an equitable interest in the corpus of the property and as such becomes entitled to the income therefrom in his own right and not by derivation from the assignor. Accordingly, since the tax was

upon income as to which, in the general application of the federal acts, the tax liability attached to ownership, the conclusion was reached that the action of the commission in taxing the assignor was erroneous.

(5) SOCIAL SECURITY

In his discussion last year of the tax burden of the supreme court, 1935 term, Professor Lowndes said that the bearing of the Butler case upon the social security act was happily beyond the scope of his paper; and that what the supreme court would say remained to be seen. The supreme court has now spoken in three cases: *Carmichael v. Southern Coal & Coke Company*, — U. S. —, 57 S. Ct. 868, 81 L. Ed. 811 (1937); *Stewart Machine Company v. Davis*, — U. S. —, 57 S. Ct. 883, 81 L. Ed. 779 (1937); and *Helvering, et al. v. Davis*, — U. S. —, 57 S. Ct. 904, 81 L. Ed. 804 (1937), and the constitutionality of the social security acts, both state and federal, has been sustained, although by a divided court.

In the Stewart case, the question involved the validity of the tax imposed by the social security act on employers of eight or more. The assailants of the act contended that the tax was not an excise; that it was not uniform throughout the United States, as excises are required to be; that its exceptions were so many and arbitrary as to violate the fifth amendment; that its purpose was not revenue but an unlawful invasion of the reserve powers of the states; and that the states in submitting to it had yielded to coercion and had abandoned governmental functions which they were not permitted to surrender.

All of these contentions were rejected. The court found that the tax was an excise as distinguished from a direct tax and that it conformed to the uniformity requirement; that it was not offensive to the provisions of the fifth amendment by force of its exemptions, the federal government being permitted the same latitude of judgment in classification as that permitted to the states under the fourteenth amendment, which, unlike the fifth, embodies an equal protection clause; and that the purpose underlying the act was to find a method by which public agencies, both state and federal, might work together to the common end of relieving economic distress through a mutual sharing of the financial burden. For a precedent it cited the case of *Florida v. Mellon*, 273 U. S. 12, 47 S. Ct. 265, 71 L. Ed. 511 (1927). The court further found that the statute did not call for a surrender by the states of powers essential to their quasi sovereign existence, since they were in large measure left free to accept or reject the provisions of the act.

In the Carmichael case, the questions for decision were whether the unemployment compensation act of Alabama infringed the due process and equal protection clauses of the fourteenth amendment and whether it was invalid because its enactment was coerced by

the action of the federal government in adopting the social security act and because it involved an unconstitutional surrender to the national government of the sovereign powers of the state. The validity of the statute was attacked on the ground that it was an infringement of the due process and equal protection clauses of the fourteenth amendment; as an unconstitutional surrender to the United States of the sovereign power of the state; and as a measure owing its passage to the coercive action of congress in the enactment of the social security act.

The validity of the tax under the fourteenth amendment was sustained upon the inherent power of a state to select the subjects of taxation and to grant exemptions, under the familiar rule that neither the due process nor equal protection imposes upon a state any rigid rule of equality of taxation.

With respect to the validity of the tax as determined by due process, the court found that the public purpose doctrine embraced expenditures for the general welfare of the state, and that what is general welfare is a practical question to be answered by the law-making department.

With respect to the want of relationship between the subjects and the benefits of the tax, the court pointed out that it has never been thought that any direct correlation between benefit and burden was essential to the validity of a tax; and the argument of coercion was answered by the suggestion that nothing in the constitution prohibits cooperation between the states and the federal government.

Interest in the Davis case lies largely in the exposition by the court of its interpretation of the meaning of the phrase "general welfare" as used in the taxing clause of the federal constitution. Referring to the case of *United States v. Butler*, 297 U. S. 1, 56 S. Ct. 312, 80 L. Ed. 477 (1936), and to the court's acceptance of the conception of the spending power advocated by Hamilton rather than that advocated by Madison, the court said:

" . . . Yet difficulties are left when the power is conceded. The line must still be drawn between one welfare and another, between particular and general. Where this shall be placed cannot be known through a formula in advance of the event. There is a middle ground or certainly a penumbra in which discretion is at large. The discretion, however, is not confided to the courts. The discretion belongs to congress, unless the choice is clearly wrong, a display of arbitrary power, not an exercise of judgment. This is now familiar law. 'When such a contention comes here we naturally require a showing that by no reasonable possibility can the challenged legislation fall within the wide range of discretion permitted to the congress.' Nor is the concept of the general welfare static. Needs that were narrow or parochial a century ago may be interwoven in

our day with the well-being of the nation. What is critical or urgent changes with the times."

To paraphrase the language of Chief Justice Marshall, the court remembered that it was a constitution it was expounding—and it bowed to what has come to be the inevitable.

(6) FEDERAL EXCISE TAXATION

On June 19, 1934, congress, pursuant to a message from the president dated May 22nd recommending the imposition of a tax of fifty per centum on the profits resulting from the transfer of an interest in silver, passed the silver purchase act, effective as of May 15th of that year. The statute was applied to silver futures bought prior to the effective date of the act and sold prior to the date of its enactment. After paying the tax on his profits, the taxpayer took appropriate steps to recover the payment so made. The court of claims sustained his claim, holding that the statute was unconstitutional as applied to sales completed before the date of enactment; but, on certiorari, its judgment was reversed on the ground that the tax was a special income tax which could be levied retroactively for a reasonable period, and that in view of congressional discussion concerning silver and the president's message, the period beginning May 15th was not unreasonable. *United States v. Hudson*, 299 U. S. 498, 57 S. Ct. 309, 81 L. Ed. 261 (1937).

An excise is generally regarded as a tax upon the exercise of some form of privilege, and where a privilege has been fully exercised before the date of enactment of a tax measure, the due process clauses of the fifth and fourteenth amendments have absorbed the shock of retroactivity. *Nichols v. Coolidge*, 274 U. S. 531, 71 S. Ct. 1184, 47 L. Ed. 710 (1927); *Untermeyer v. Anderson*, 276 U. S. 440, 48 S. Ct. 353, 72 L. Ed. 645 (1928). In some cases, however, e. g., those involving the income tax, some retroactivity has been permitted on the theory that knowledge of the impendency of the tax will not affect the taxpayer's normal pursuit of gainful activities. *Cooper v. United States*, 280 U. S. 409, 50 S. Ct. 164, 74 L. Ed. 516 (1930). Lying between these two classes of cases are those in which the taxation of interests over which the taxpayer has surrendered the power of control prior to the enactment of the statute where afterwards the occurrence of the event taxed is sufficient of itself to justify the tax, has been upheld. *Burnet v. Wells*, 289 U. S. 670, 53 S. Ct. 761, 77 L. Ed. 1439 (1933). By utilizing the concept of "special income," the court now seems to extend these decisions to a situation where nothing occurs after the passage of the statute; and its decision, therefore, may establish a precedent for supporting the retroactive features of the "windfall" tax. By comparison, however, the silver purchase act, except as to hedging transactions, is more extreme than the "windfall" tax since it taxes

retroactively the profit from each transfer without reference to losses which were incurred upon similar transactions, whereas the "windfall" tax act, in imposing a retroactive tax of eighty per centum upon that part of the income of the vendor which had been derived from the sale of goods upon which an excise tax under the agricultural adjustment act had been imposed but not paid, and which was attributable to shifting the burden of the tax, limits the total income so taxed to an amount not to exceed the net income of the vendor for the taxable year with respect to the sale of such goods.

In commenting on this case, the *Harvard Law Review*, 50 H. L. R. 841 (1937), says:

"The principal case, by approving the tax on sales of silver futures from May 15, 1934, a time when there was no intimation that such a tax would be imposed, leaves considerable doubt as to the criteria to be employed in determining the extent of a reasonable period of retroactivity. Thus, when balancing the chance of gain against the risk of loss in a proposed investment, the taxpayer must not only guess the outcome of pending tax measures but also consider the possibility of a future tax as an adjunct to other pending legislation."

(7) FEDERAL PROCEDURE—EXCISE TAXATION

In his paper last year with reference to the recovery of processing taxes paid under the agricultural adjustment act, subsequently held unconstitutional, Professor Lowndes said:

"The most pressing problem for the average tax practitioner, left from the wreckage of the A.A.A., is whether the processors are going to be able to recover the taxes which were held to be unconstitutional in the *Butler* case, or whether the device of requiring them to prove that they neither passed on nor passed back the taxes, as a condition precedent to refunds, will prove successful. The only case before the court at the last term which might have shed some light on this question was completely neutral. *Rickert Rice Mills, Inc. v. Fontenot* (1936), 56 Sup. Ct. 374, in which the supreme court granted a temporary restraining order against the collection of processing taxes and after the decision in the *Butler* case, ordered the taxes impounded under this order to be returned to the processors, carefully refrained from passing upon the constitutionality of the procedure which requires the processors to prove absorption of the taxes as a condition precedent to their recovery. As you are undoubtedly aware, several district courts have held that this is constitutional. What the supreme court will say remains to be seen."

In *Anniston Manufacturing Company v. Davis*, — U. S. —, 57 S. Ct. 816, 81 L. Ed. 722 (1937), the court sustained the constitutionality of title 7, sections 901-917 of the Revenue Act of 1936, which provided a new administrative procedure for the recovery of amounts collected under the agricultural adjustment act. In support of its amended complaint asserting the unconstitutionality of these provisions, the petitioner contended that at the time it filed its original suit it had a vested right of action against the collector to recover the amounts exacted under statutory provisions held to be invalid; that this right of action could not be destroyed without violating the fifth amendment; that the collector was personally liable for the amounts collected; and that section 910, which attempted to destroy that liability, was unconstitutional. The court, however, sustained the government's contention that congress might withdraw the remedy against the collector, provided it had left a remedy against the government which was fair and adequate in every respect. It then turned its attention to the sufficiency of the remedy which was provided by the sections of title 7 of the Revenue Act of 1936, heretofore referred to.

With respect to floor stock taxes, the court found that the remedy by suit had been expressly preserved; and that if the commissioner refused refund, suit might be brought against the United States in the court of claims or in the district court for the recovery of the amount claimed to have been illegally exacted.

With respect to the refunding of processing taxes, the court exhaustively discussed the special and exclusive administrative procedure which had been provided. It found that the requirements of due process of law had been met and that the provisions of the statute dealing with burden of proof and presumptions, in connection with whether the burden of payments made had been shifted, were not so arbitrary as to deprive the taxpayer of his opportunity to make a full presentation of the facts of his case at the appropriate time; and it dismissed the petitioner's contention as to impossibility of proof as premature. Mr. Chief Justice Hughes in part said:

"For the present purpose it is sufficient to hold, and we do hold, that the petitioner may constitutionally be required to present all the pertinent facts in the prescribed administrative proceeding and may there raise, and ultimately may present for judicial review, any legal question which may arise as the facts are developed."

Justices Stone and Cardozo concurred in the opinion, reserving, however, their vote as to the constitutional or statutory rights of the taxpayer in the event that it should be impossible to ascertain whether there had been a shifting of the tax.

(8) STATE TAXATION—COMMERCE CLAUSE

A decision of prime importance to states adopting the use tax as a prophylaxis for avoidance of their sales taxes was made in *Henneford et al. v. Silas Mason Company, Inc., et al.*, 300 U. S. 577, 57 S. Ct. 524, 81 L. Ed. 526 (1937), where the validity of the statute of the state of Washington, taxing the use in that state of chattels purchased in another state, was sustained over the objection that it violated the commerce clause.

The statutes of Washington imposed a sales tax of two per centum upon every retail sale in that state, with enumerated exceptions, and a compensating tax for the privilege of using within the state any article of tangible personal property purchased subsequent to April 30, 1935, at the rate of two per centum of the purchase price, including in such price the cost of transportation from the place where the article was purchased. The statute further provided, however, that the use tax should not be laid unless the property had been bought at retail and that it should not apply to the use of any article of tangible personal property, the sale or use of which had already been subjected to a tax equal to or in excess of that imposed therein, whether under the laws of that or some other state of the United States. Where, however, the rate of such other tax was less than two per centum, the exemption was not complete, but was measured by the difference between it and the rate thereby imposed.

In reaching its conclusion, the court pointed out that the tax was not upon the operations of interstate commerce, but upon the privilege of use after such commerce was at an end. While recognizing that a tax upon use might be so closely connected with delivery as to be in substance a part thereof and, therefore, subject to the same objections that would be applicable to a tax upon the sale itself, such objections were not open to the plaintiffs in the instant case, since the property with respect to the use of which the tax was imposed had had continuous use in Washington long after the time of delivery had passed. Further, the court found that the tax upon the use after the property was at rest was not measured or conditioned so as to hamper transactions in interstate commerce or to discriminate against them; that the motive underlying the statute was to produce a condition of equality between purchasers within and without the state; and that there was no merit in the contention that the tax was in effect a protective tariff since it did not burden the very act of importation. The court was, however, careful to indicate that nothing in its opinion should be taken to imply that allowance of credit of other taxes paid to Washington made it mandatory that there should be a like allowance for taxes paid to other states, the question of whether or not a taxpayer paying in

the state of origin might be compelled to pay again in the state of destination being expressly left for future determination.

With respect to the requirements of the equal protection clause of the fourteenth amendment, the contention that the tax though in form upon the use was in fact upon the foreign sale and, therefore, a subterfuge, because the statute provided that the use should not be taxable if the chattel was manufactured by the user, or received as a legacy, or acquired in any way except through the medium of a retail purchase, was rejected on the ground that the legislature had merely exercised a choice in classification, permitted under that amendment.

(9) STATE TAXATION—CONTRACT CLAUSE

The power of a state to impose an excise tax upon persons having a direct and beneficial interest in the production of oil, irrespective of the manner in which the business is carried on, was sustained in *Barwise, et al. v. Sheppard, et al.*, 299 U. S. 33, 57 S. Ct. 70, 81 L. Ed. 17 (1936). Putting aside mere characterizations of the tax, the court rejected contentions of the taxpayer that the provisions of a Texas statute, as an arbitrary fiat, denied due process of law or impaired the obligations of his contract. At the time of the enactment of the statute, the taxpayer was receiving royalty "equal to $\frac{1}{8}$ th part of all oil produced . . . free from cost in the pipe line," as lessor under a lease investing the lessee with the privilege of exploring for and producing oil, and the lessee was paying the tax on all oil produced under a law which imposed it on the lessee alone as the active producer. Recognizing the power of the state, in general, to lay an excise on the production of oil, the court found that under the terms of the lease under which the oil was produced the lessor and lessee were engaged in a common venture for their mutual benefit and that there was, therefore, no offense against the due process clause.

With respect to the contract clause, the court further found that the lease contained no mention of taxes or their payment; and it thought that the view was not inconceivable that the phrase "free of cost" referred merely to production expenses and not to governmental exactions, such as a tax. Not being content, however, to rest its decision on so narrow a ground, the court held that since the statute did not purport to reach or affect any term of the lease as such, no stipulation therein could be of any avail against the power of the state to impose the tax, prescribe who should be under a duty to the state to pay it, or fix the time and mode of payment, even though the lessor and lessee were privileged, *inter sese*, to stipulate who should ultimately bear it, under the well-established doctrine subordinating contracts to the exercise of the taxing power. In other words, the existing lease presented no obstacle, as the court said, to a change in tax laws at any time and to a redistribution of the burden admittedly within its power to impose.

(10) STATE TAXATION—FOURTEENTH AMENDMENT

The scope of a state's power to tax income has been re-examined in two cases coming from New York, with the result that the basis of the concept of "business situs" has been somewhat extended, and the hostility toward multiple taxation somewhat abated. In the first case, *People ex rel, Whitney v. Graves*, 299 U. S. 366, 57 S. Ct. 237, 81 L. Ed. 195 (1937), the imposition of an income tax by the state of New York upon the profits derived from the sale of a "right" to one-fourth of a new membership in the New York Stock Exchange by a resident of Massachusetts, was sustained. In challenging the jurisdiction of New York to lay the tax, stress was placed upon the non-residence of the taxpayer and the non-exercise of the privileges incident to membership in the stock exchange within the territorial limits of the state; and reliance was placed upon the application of the maxim *mobilia sequuntur personam* to establish the situs of the "right" as a species of intangible personal property in Massachusetts, the domicile of its owner, in the absence of the acquisition of a "business situs" rendering it taxable in New York, which, it was contended, had not been acquired because no business had been transacted by the taxpayer in that state.

The court held, however, that the argument failed to give adequate consideration to the nature and incidents of the membership. The use of the metaphoric phrase, "business situs" expressed merely the idea of localization by virtue of the attributes of the intangible right in relation to the conduct of affairs at a particular place. Such localization might grow out of the actual transactions of a localized business (local exercise of privileges) or it might be identified with a particular place because the exercise of the right was fixed exclusively or dominantly at that place (locally exercisable privileges). In other words, localization of the privilege to do might constitute a business situs quite as clearly as a localized doing. Hence, when it was found that the privilege which underlies or inheres in membership in the exchange was dominantly localized upon its floor, the court concluded that a tax upon the income derived from its sale was within the power of the state where the exchange was located; and it found nothing in its earlier decisions to the contrary.

In the other case, *People of the State of New York ex rel. Cohn v. Graves, et al.*, 300 U. S. 308, 57 S. Ct. 466, 81 L. Ed. 409 (1937), the question presented was whether the state of New York may constitutionally tax a resident upon income received from rents of land located without the state and from interest on bonds physically without the state and secured by mortgage upon lands similarly situated. The court sustained the validity of the tax.

It was argued by the taxpayer that the tax was in substance and effect a tax on real estate and tangible property located without

the state, in violation of the Fourteenth Amendment of the Constitution of the United States. In deciding the case the court assumed that New York may not levy a property tax upon the taxpayer's interest in land situated beyond the state, whether it be legal or equitable; and it limited its review to the question considered and decided by the state court, whether there is anything in the fourteenth amendment which precludes the state of New York from taxing the income merely because it is derived from sources which to the extent indicated are located outside the state.

In sustaining the tax the court said that the receipt of income by a resident of the territory of the taxing sovereignty is a taxable event, that domicile itself affords a basis for such taxation, and that the privileges and obligations arising therefrom are in no way affected by the character of the source from which the income is derived. Although it did not appear that the income had been taxed in New Jersey, the court thought that fact was immaterial because the imposition of different taxes by the same or different states, upon a distinct and separate taxable interest, is not subject to the objection of double taxation which has been successfully urged in cases where two or more states have laid the same tax upon the same property interest in intangibles or upon its transfer at death. Moreover, it found nothing inconsistent with this view in the Pollock case, since the inquiry in that case concerned itself in whether or not the tax was direct within the apportionment requirement. The court pointed out that in *Union Refrigerator Transit Company v. Kentucky*, 199 U. S. 194, 26 S. Ct. 36, 50 L. Ed. 150 (1905), the present question was not thought to be foreclosed, nor was *Senior v. Braden*, 295 U. S. 422, 55 S. Ct. 800, 79 L. Ed. 1520 (1935) an obstacle, since in that case the tax was upon an equitable interest in land wherein here the subject of the tax was the receipt of income.

On the question of the taxability of income from bonds physically without the state and secured by mortgage upon lands likewise without the state, the court reached the same conclusion as it did with respect to the income from rents. To the taxpayer's argument that the bonds had acquired a business situs in New Jersey, the court said that the record presented no facts which would establish a business situs.

The reference to *Senior v. Braden* compels me to confess that I wrote the brief in that late lamented cause. Much of the story of its unhappy ending does not appear in the record. It is enough now to say that the shadow which it threw on the symmetrical development of the law of taxation seems to grow less, and to express the hope that the views of the dissent, which seem so sound, may in time come to prevail.

The concept of business situs was further developed in *First Bank Stock Corporation v. State of Minnesota*, 301 U. S. 234, 57 S. Ct. 677, 81 L. Ed. 644 (1937), where the question was whether a Delaware corporation doing business in Minnesota might be required, consistently with the due process clause of the fourteenth amendment, to pay a property tax laid by Minnesota upon its shares of stock in Montana and North Dakota state banking corporations.

The corporation qualified in Minnesota and in fact transacted its corporate business and fiscal affairs there. It owned a controlling interest in the stock of a large number of banks, trust companies and other financial institutions, located in the Ninth Federal Reserve District. The stock certificates were kept in Minnesota where the corporation received dividends declared by its subsidiaries and where it declared and disbursed dividends upon its own stock. The court held that the shares in question were subject to the Minnesota tax.

In its opinion the court notes that the corporation was to be regarded as legally domiciled in Delaware, the place of its organization, and as taxable there upon its intangibles, at least in the absence of activities identifying them with some other place as their business situs. It found, however, that the business which the corporation carried on in Minnesota or which it directed from its offices maintained there was sufficiently identified with Minnesota to establish a "commercial domicile" there, and to give a business situs there, for purposes of taxation, to intangibles which were used in the business or which were incidental to it, and which had thus "become integral parts of some local business."

The corporation did not challenge the tax imposed on its shares of stock in corporations organized and doing business without the state, other than those in Minnesota and North Dakota banks. With respect to them it said that these states have adopted the only feasible scheme of taxation of the shares of state banks which will admit of a state property tax on national bank shares, under R. S. #5219 as amended. (12 U. S. C. A. 548.) Both of the states mentioned assess for property taxation the shares of national banks doing business within their limits and assess in like manner the shares of state banks, thus avoiding discrimination in taxation between the two. On this basis the corporation argued that every state might establish a tax situs within the state for shares of stock in its own banking corporations; that Montana and North Dakota had done so by providing, in pursuance of their scheme for the local taxation of banking corporations, that the shares should be taxable there; and that as the shares were properly taxable by the respective states of their origin, due process forbade the imposition of a property tax upon such shares or intangibles in more than one state and, therefore, they could not be taxed in Minnesota.

The court did not find it necessary to decide whether taxation of the shares in Montana or North Dakota was foreclosed by sustaining the Minnesota tax, nor did it inquire whether a nonresident shareholder, by acquiring stock in a local corporation, so far subjects his investment to the control and laws of the state which has created the corporation as to preclude any objection, on the grounds of due process, to the taxation of the shares there, even though they are subject to taxation elsewhere, at their business situs; rather it expressly left those questions open, finding for present purposes that it was enough that the power to tax shares of stock at the place of the domicile of the owner had often been upheld and never been denied. At the same time, however, the court recognized that intangibles might acquire a business situs and thereby become subject to taxation irrespective of the place of domicile of their owner, since the considerations which support taxation at the place of domicile find their counterpart at the place where a business situs is acquired.

Great Atlantic & Pacific Tea Company v. Grosjean, — U. S. —, 57 S. Ct. 772, 81 L. Ed. 735 (1937).

The question presented in this case was whether the method prescribed by a chain store tax act for ascertaining the rate of taxation offends the fourteenth amendment and the commerce clause of the federal constitution. The legislature of Louisiana had adopted an act levying an occupation or license tax upon chain stores on a graduated basis which determined the amount of the tax by reference to the number of stores in the chain both within and without the state of Louisiana. The objection to the validity of this feature of the act was that it embodied an arbitrary discrimination in favor of local as against national chains, in the attempt to tax property and activities which were beyond the state's jurisdiction and in burdening interstate commerce. The court held the legislature impregnable to attack on these ground.

With reference to the first, the court noted that the exaction was an occupation or license tax upon the conduct of a business within Louisiana. Referring to earlier cases it found that a state, without contravening the equal protection clause of the fourteenth amendment might separately classify for taxation the conduct of a chain store, and might increase the rate in proportion to the increase in the number of stores within the state, since the opportunities and powers of a chain store operator became greater with the growth of the number of units maintained; and it further found that the competitive advantages of a chain increase with the number of its component links, without regard to the location of the stores. The taxpayers urged that the act arbitrarily discriminated in favor of local chains because it was inconceivable that a chain operating wholly within the state would have 500 stores, not to mention up-

wards of 15,000, the number maintained by the Atlantic & Pacific. But the court said that this argument was 'inconsistent with the finding that additional units, wherever situate, increase the advantages and economic effects of the chain as a whole and of each unit, and ignored the possibility that a chain store company of national scope might well be incorporated in Louisiana, with stores in that state rated for taxation according to its total stores within and without the state.

Further, it was argued that the statute, by taking into account all units indiscriminately in fixing the rate, arbitrarily disregarded the value of the local privilege for which the license fee was charged. To this the court answered that classification of chains according to the number of units should not be condemned because another method more nicely adjusted to represent the differences in earning power of the individual stores might have been chosen, it being enough that the classification had reasonable relation to the differences between small and large chains.

With reference to the contention that the act deprived the taxpayers of property without due process of law because the tax was imposed, at least in part, upon things which were beyond the jurisdiction of Louisiana, the court found that the subject of the tax was the prosecution of a defined business activity within the state—a legitimate subject of a license or occupation tax—and that, therefore, in legal contemplation the state did not lay a tax upon property lying beyond her borders nor did she tax any privileges exercised and enjoyed by the taxpayer in other states. It relied upon the case of *Maxwell v. Bugbee*, 250 U. S. 525, 40 S. Ct. 2, 63 L. Ed. 1124 (1919), as going far to sustain the validity of the act, but expressly declared that its decision need not rest on conceptions of subject, measure and rate of tax—that the taxing power might be made the implement of the exercise of the state's police power under which proper and reasonable discrimination between classes to promote fair and competitive conditions and to equalize economic advantages might be made. Accordingly, it was not a denial of due process to adjust license taxes to meet the local evil resulting from business practices and superior economic power even though those advantages and that power were largely due to the fact that the taxpayer did business not only in Louisiana but in other states.

The majority decision was rendered by four judges, Justices Van Devanter and Stone taking no part in the consideration or decision of the case. Mr. Justice Sutherland dissented for himself and Justices McReynolds and Butler. The ground of the dissent was that the majority decision extended the decision in the Jackson case to a point going far beyond the verge of the law and that it was an arbitrary exaction because based upon factors which the state of Louisiana should not be permitted to take into account. The dissenting opinion read in part:

"The exaction here involved is not a tax upon Louisiana property or business, but is essentially a penalty imposed upon an operator of business wholly beyond the reach of the law of that state. We are not able to concede that it lies within the province of one state to thus indirectly penalize a method of doing business in another state, which it may be the policy of the latter to permit or, indeed, encourage."

Moreover, the minority denied the validity of the proposition that competitive advantages flow in proportion to the number of links in the chain, wherever situated. To a considerable extent the dissent reiterated the views set forth in the dissenting opinion in the Jackson case and what was said by the court in the Stewart Dry Goods case.

In *Binney v. Long*, 299 U. S. 280, 57 S. Ct. 206, 81 L. Ed. 153 (1936), the question of the validity of a retroactive death tax of the commonwealth of Massachusetts was considered. A trust had been created by deed *inter vivos* in 1877 reserving a life estate to the grantor with a contingent remainder to her children, the grantor reserving no power to revoke, alter or amend. At that time there was no transfer or succession tax in force in Massachusetts. When the settlor died, in 1931, Massachusetts sought to impose a succession tax, under an act passed in 1907, upon receipt by the children of their interests under the trust. The children resisted the imposition of the tax, claiming that, as applied, the taxing statute was arbitrarily retroactive, contrary to the fourteenth amendment. The supreme court, however, held that since the remainders to the children did not vest until after the death of the settlor, the retroactive operation of the tax did not deprive them of property without due process of law and that the tax could be validly imposed.

The taxpayer relied on *Coolidge v. Long*, 282 U. S. 582, 51 S. Ct. 306, 75 L. Ed. 562 (1931), asking the court to disregard the "illusory and insubstantial" distinction between remainders contingent and remainders vested but subject to divestment by condition subsequent. But the court preferred to be consistent. In upholding the tax, it said:

"The contention was made and rejected in *Coolidge v. Long*. The fact that the remainders were vested from the date of the deed, and the interests of those who took in remainder were merely subject to be defeated by a condition subsequent, was the basis for the conclusion that the tax could not constitutionally be laid upon the occasion of their acquiring physical possession of what had, in the eye of the law, long been their property. Having relied on legal rather than practical considerations to invalidate the tax in *Coolidge v. Long*, it would be inconsistent here to rely on practical rather than legal consid-

erations to invalidate the same tax. The commonwealth was not prevented by the constitutional provisions which the appellants invoke from taxing the succession under the 1877 trust upon the occasion of the intestate's death since the appellants' estates never vested until that event."

For a scholarly discussion of this case see 50 Harvard Law Review 206, 31 Illinois Law Review 125 (1936); see also 37 Columbia Law Review 874 (1937), where the validity of the statute as applied to this case was considered under the equal protection clause.

In *Bourjois, Inc. v. Chapman*, 301 U. S. 183, 57 S. Ct. 691, 81 L. Ed. 688 (1937), the question considered was the validity of an act for the regulation of cosmetics passed by the legislature of the state of Maine in 1935. *Bourjois, Inc.*, a New York corporation, sought to enjoin the enforcement of the act on the ground that it was offensive to the commerce clause and the equal protection of the laws clauses of the fourteenth amendment of the federal constitution. The act provided for the regulation of cosmetics by requiring the registration of such preparations as a condition precedent to their sale within the state and by imposing an annual fee of 50c. per preparation, the fees received to be used by the department of health and welfare for carrying out the purposes of the act. Section 1 of the act, requiring the registration of cosmetics, restricted its application to transactions in intrastate commerce only. The court sustained the statute.

One of the objections to the validity of the act made by the plaintiff was that the requirement of the payment of a fee was invalid under the commerce clause because the state had failed to show that the fee charged was not in excess of the cost of inspection. On this point the court held that, assuming it to be necessary for the state to establish that the fees charged were not excessive, it had here sustained the burden. The size of the fee suggested that it might prove inadequate rather than excessive. Further, in view of the fact that the case had arisen before the statute became operative rendered it impossible then to determine whether the fees would prove to be in excess of the administrative requirement and under these circumstances it was sufficient if it is shown that the charges were not unreasonable on their face; and in any case, since the fee applied to interstate commerce only indirectly, the burden was upon the one challenging the legislation to show an actual undue burden upon such commerce.

The objection that the requirement of the payment of the fee violated the equal protection clause of the fourteenth amendment was summarily disposed of. The statute provided that the fees collected should be devoted solely to the enforcement of the act which directly regulated but one class of activity, and the record showed that the state treasury had set up a separate account to which all

cosmetic fees were credited and against which were to be charged only the expense of enforcement. Hence, no question of the denial of equal protection was presented.

In the case coming from the state of Washington, *Great Northern Railway Company v. State of Washington*, 300 U. S. 154, 57 S. Ct. 397, 81 L. Ed. 350 (1937), the constitutionality of a state statute imposing cost of regulation upon public utilities was involved. The statute imposed upon all utilities doing business in the state a fee of one-tenth of one per cent of gross operating revenues derived from interstate operations. The proceeds of the tax were commingled in a revolving fund to defray all of the expenses of the department of public works, no separate accounts being kept of expenditures upon the regulation of each type of utility or for each activity of the department. The railroad paid the fees under protest and sought to recover them on the ground that the statute imposed an unconstitutional burden upon interstate commerce and violated the equal protection and due process clauses of the fourteenth amendment. It was contended that the commingling of total revenues and expenditures of a portion of them for such allegedly nonregulatory functions as the activities of the department in the interest of interstate shippers and in the trial of reparation cases placed upon the state the burden of proving that the fees collected from railroads did not exceed the sums expended in their legitimate regulation. The court held for the plaintiff on the ground that although the statute was valid on its face, the burden of proof that the sums collected from the railroads did not exceed the reasonable cost of the proper regulatory functions was upon the state and that it had failed to sustain the burden. Mr. Justice Cardozo wrote the dissenting opinion, in which the Chief Justice, Mr. Justice Brandeis and Mr. Justice Stone joined.

The decision of the court in this case seems to reverse the usual presumption of constitutionality in statutes of this type. Although it turned upon the allocation of the burden of proving the reasonableness of the fees, its broad significance seems to lie "in the implied assumption that if a state includes all types of public utilities in a single class for the purpose of computing these fees, they will be declared unconstitutional upon proof that the exactions from any group of utilities are in excess of the disbursements for that particular group. This segregation into groups seems to be an unwarranted innovation." 46 Yale Law Journal 1251-1254 (1937).

In the first case dealing with the effect of the adoption of the twenty-first amendment, *State Board of Equalization of California, et al. v. Young's Market Company, et al.*, 299 U. S. 59, 57 S. Ct. 77, 81 L. Ed. 37 (1936), the Young's Market Company, a California corporation, had engaged prior to 1935 in selling imported beer at wholesale within the state under a license costing \$50, which

entitled it to sell imported or domestic beer legally possessed to licensed dealers in California. In that year California passed a statute imposing a license fee of \$500 for the privilege of importing beer to any place within its borders. The company refused to apply for an importer's license and sought to restrain the enforcement of the act, claiming that the requirements of the statute discriminated against wholesalers of imported beer, in violation of the commerce and equal protection clauses of the federal constitution. State officials charged with the duty of enforcing the statute asserted that the challenged statutory provisions and regulations were valid under the twenty-first amendment, which provides, by section 2, that: "The transportation or importation into any state, territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited."

It was not denied that prior to the twenty-first amendment it would have been unconstitutional to have imposed any fee for the privilege of importing beer from another state. Such an imposition would have been void, as a direct burden on interstate commerce, the commerce clause conferring the privilege of importing merchandise free into any state except as congress might otherwise provide; and this conclusion would have been true irrespective of whether or not the state had exacted an equal fee for the privilege of transporting domestic beer from its place of manufacture to the wholesaler's place of business. By the adoption of the twenty-first amendment, however, the limitation imposed by the commerce clause upon the power of the state in its relation to the importation of intoxicating liquor from other states was removed. The court found that the language of the twenty-first amendment was apt to confer upon the state power to forbid all importations which did not comply with the conditions thereby prescribed; and that the adoption of the construction for which the plaintiff contended, namely, that while the state might prohibit the importation of intoxicating liquors, provided it prohibited manufacture and sale within its borders, it could not permit such manufacture and sale unless it let imported liquors compete with domestic on equal terms, would involve not a construction but a rewriting of the amendment.

Undaunted, however, the plaintiff argued, first, that despite the amendment, the regulatory power of the state was co-extensive with the reach of its police power only, and that since the importer's license fee was not imposed to that end, it was invalid; and second, that limitations of the broad language of the twenty-first amendment were sanctioned by its history and by the decisions of the court on the Wilson act, the Webb-Kenyon act, and the Reed amendment.

In rejecting both of these contentions the court thought, first, that the imposition of an importer's license fee was a means reasonably available for the promotion of an end within the scope of the

state's police power; and second, that the clear language of the amendment relieved it of the necessity of further discussion. Moreover, it felt that the question for decision did not require it to adopt the broad generalization urged by the plaintiff, namely, that to sustain the exaction of the importer's license fee would involve a declaration that the amendment had, in respect to liquor, freed the states from all restrictions upon the police power to be found in other provisions of the constitution.

With respect to the further contention that the statutory provisions and regulations were void under the equal protection clause, the court held that a classification recognized by the twenty-first amendment could not be deemed forbidden by the fourteenth; and that in any event the classification in taxation made by California rested on conditions requiring difference in treatment, which obviously, if true, rendered it inoffensive under that clause.

Section 2 of the twenty-first amendment, which closely parallels the terms of the Webb-Kenyon act, was proposed by congress to dispel doubts as to the constitutionality of such legislation and to foreclose the possibility of a return by repeal of that act to obvious limitations upon the power of the state to regulate the liquor traffic. Nevertheless, the district court had held that the state could not regulate liquor in interstate commerce unless it prohibited all commerce in liquor. The effect of its decision was thus to impose a limitation upon the power of a state under the twenty-first amendment which had not existed under the Wilson act. By reversal of the district court and by recognition of the abrogation of the commerce clause *pro tanto*, it is submitted that the supreme court seems to have given effect both to the purpose and to the plain words of that amendment.

With respect to the contention based upon the equal protection clause of the fourteenth amendment, the court in saying that "a classification recognized by the twenty-first amendment could not be deemed forbidden by the fourteenth," seems to have found an abrogation of that clause also, in so far as discrimination against liquor transported into the state is concerned. If this is true, then indeed the Webb-Kenyon act has become exacted by the amendment, although that result seems not consciously to have been contemplated by its framers.

CHAIRMAN TOBIN: We want to thank you, Mr. Lavery, for your excellent job, which is not an easy job—to give all these very important cases as they have passed through the supreme court of the United States, and I am sure that your treatment of the same will be helpful to a full discussion of this important phase of the problem of taxation as we move along in this session.

It is indeed fortunate for the association and for the delegates present at this conference that we have as the person who will discuss these cases the professor from Duke University Law School who last year was kind enough to do such a job as has been done by Mr. Lavery tonight.

We feel very happy in having with us tonight Mr. Lowndes, professor, Duke University Law School, who will take up the discussion of the cases that have just been reviewed by Mr. Lavery.

CHARLES L. B. LOWNDES (North Carolina): Mr. Chairman, Dr. Lavery has told you in some detail about some of the tax cases decided by the supreme court at the last term. To invoke an over-worked figure of speech, he has told you about the trees. I would like, not as a supplement but rather as a complement—that by the way is “ple” but can very well be “pli”—to his paper, to talk about the forest, to give you my impressions of the cases at the last term, the tax work of the last term, as a whole.

When you follow the supreme court cases for any length of time, you are impressed by the fact that the same old problems keep cropping up year after year. You can take—as a matter of fact I did take—the cases decided at the 1936 term and fit them under exactly the same headings that you used to classify the cases at the 1935 term. The same old problems come up again and again. Either our technique for making legal rules that will stick is faulty, or these are very perplexing problems indeed.

For example, there were the usual group of cases on interstate commerce. There were three cases that involved the time-worn distinction between a constitutional fee and an unconstitutional tax. There was one case that involved an Alabama franchise tax, which had already been before the supreme court in another case. This time, however, the court upheld the tax. The time before they held it was bad.

The only two cases on commerce which present or suggest any new or novel problems are the Henneford case, which upheld the Washington use tax, which I understand Mr. Powell is to talk about, and which is of some practical as well as academic importance because we have use taxes in about eleven states, and the Young's Market case that Dr. Lavery just mentioned, which upheld a California license tax on an importer of beer, the theory being that the immunity of commerce in connection with liquor is repealed by implication by the twenty-first amendment.

The supreme court as usual was harassed by problems of inter-governmental immunities, as Dr. Lavery has told you. *Brush v. Commissioner* has been thought to be as somewhat of an extension of that doctrine. That is the case which held that the federal government could not impose an income tax on the salary of the chief

engineer of the New York Bureau of Water Supply. I doubt, personally, whether it extends the doctrine very much. I think the court was bemused by the enormity of the New York water system and I doubt whether the case represents much more than that.

The Graves case, *Rogers v. Graves*, which held that the New York income tax on the salary of the general counsel of the Panama Railroad Corporation was unconstitutional, does not seem to me to repudiate any possible distinction between proprietary and governmental functions of the federal government, when a state tax on a federal activity is in issue. The case dodged that question entirely by deciding that the function of the Panama Railroad Corporation was governmental. It seems to me it would be exceedingly unfair if the supreme court should hold that no federal activities could be taxed, and I don't think we should assent to a doctrine of that type until it is forced on us by a square holding of the court.

I don't think there is very much hope of reinterpreting the sixteenth amendment. There are two possible interpretations of the amendment, either that you don't have to apportion an income tax, regardless of the source of the income, or that you can tax any income, regardless of source. The supreme court has always taken the narrower interpretation, not only in these intergovernmental immunity cases, but also in the cases involving judicial salaries and income from exporting, and I don't believe there is much possibility of reinterpreting the sixteenth amendment to allow a federal tax on all state agencies. I don't see any way that the amendment could be interpreted to allow a state tax on federal activities.

It seems to me that sooner or later the supreme court will be obliged to contract these doctrines of intergovernmental immunity. There are two forces working in that direction: one is the pressing need of government for revenue, and the other is the fact that if all these new activities of government are sheltered behind tax immunity it is going to be impossible to raise that revenue; so far, however, I don't see any decided trend in the supreme court cases to limit the doctrine of intergovernmental immunities, with the possible exception of the *Liggett & Meyers Tobacco Company* case, which Dr. Lavery has spoken to you about.

As Dr. Lavery has pointed out, there are interesting developments in connection with jurisdiction to tax. The Cohn case, taken together with the Whitney case, seem to show that there are no substantial jurisdictional limitations on state income taxation. It doesn't look like the supreme court is going to do anything about multiple taxation of income, at least at this time.

It seems to me the court may be giving some indirect encouragement to double taxation in other fields, by cases like the *First National Bank Stock Corporation v. Minnesota*, which upheld a tax on shares of stock on the basis of the business situs. There is a

faint implication in Justice Stone's remarks there that perhaps other taxes will also be allowed on the same stock at the domicile of the stockholder and at the domicile of the corporation which issued the stock. Of course, Justice Stone never has been sold on the doctrine that the fourteenth amendment forbids double taxation of intangibles. It seems quite possible with a so-called liberal court that the rest of the court may welch on that doctrine, too.

I think in order to appreciate the Grosjean case you ought to transpose it against the Valentine case. The Grosjean case was the case which upheld the constitutionality of the Louisiana chain store tax, and held that a tax rate on the units in a chain in Louisiana determined by units all over the country or all over the world, was constitutional. To get the full impact of that case contrast it with the Valentine case, *Valentine v. Great Atlantic & Pacific Tea Company*, which held that an Iowa chain store tax measured by gross receipts was unconstitutional.

Their authority for that decision, of course, was the case of *Stewart Dry Goods Company v. Lewis*, which held that a Kentucky license tax, measured by gross sales, which was not, however, limited to chain stores, was constitutional.

Those cases seem to present the perfectly absurd result that the number of places where a person does business is a better indication of taxable ability than the volume of business which he does.

There are a number of other interesting cases on income taxes and death taxes, and a couple of nice points on federal stamp taxes. I can't go into those here. If they show anything they show the courts are getting tougher and tougher with the taxpayer, as you may have inferred from *Helvering v. Midland Mutual Life*, that Dr. Lavery spoke to you about.

I think the most important cases at the last term were the social security cases and the Anniston case, the processing tax case. I don't know that the political implications of the social security cases are so important. The Butler case didn't forestall those cases, and those cases will not necessarily forestall another case like the Butler case. In a changing political climate with less pressure, less heat on the court, they may get back to a different point of view.

But at any rate, the social security law is constitutional, and that adds an annual tax burden on this country of about \$4,000,000,000. Any case that involves \$4,000,000,000 a year is an important case. The Anniston case is important for the same reason. It saved the federal government about a billion and a half dollars. Whether it does more than postpone ultimate federal bankruptcy, of course, is a question you can ask yourselves. It makes the balancing of the budget a little easier, but whether it makes it easy enough, I don't know.

The tendency today is to talk of the supreme court almost entirely in superlatives. The newspapers have played up nearly every decision of the court as a titanic struggle between Tory and radical judges. The eight old men—notice I said “eight”—have been pictured variously as saints sublime or fiends incarnate. Very seldom have they been portrayed as lawyers of outstanding ability trying sincerely to solve difficult legal problems by traditional legal techniques. In the teeth of this popular picture I can only tell you that the tax work of the 1936 term presents a rather prosaic parallel of the previous terms. The social security cases and the *Anniston* case were smashing victories for the New Deal. The other cases reflect little if any of the passionate political turmoil which raged about the heads of the supreme court during the last term.

I suspect Mr. Powell is going to discuss Dr. Lavery's paper, too. I have seen him making notes all the time, and he is probably a better discussor than I am.

CHAIRMAN TOBIN: Thank you, Mr. Lowndes. We are indeed indebted to you, as we were to Mr. Lavery, for your fine exposition of these recent court decisions, which should help us all to get better and more efficient tax laws in like channels.

Our next speaker needs no introduction to a national tax conference. He has long been a friend of the group that has met over a period of some thirty years. He has helped in many ways to make these conferences better, and he has helped in many other ways to see that what laws we had affecting taxation were constitutional.

It is with great pleasure that I introduce Professor T. R. Powell, of the Harvard Law School.

T. R. POWELL (Massachusetts): Mr. Chairman, President Leser, and Members of the conference: I don't suppose it is my function to discuss or even to “cuss” the preceding speakers. But I was amazed at the temerity of Mr. Lowndes in suggesting that he understood what I was going to talk about. I am sure that when I am through we won't understand what I have talked about.

Speaking of balancing the budget, those of you who have already been fortunate enough to see the play that is now running will understand when I say that I would rather be right than be Tom Lavery. I only wish I could be both, as George Cohan finally conceded that he wished, but of course, that is impossible.

There is only one trouble with Tom Lavery's speech. That is that he didn't give the dates of the decisions, because we have had lots of different law since the spanking process began—from what we had before.

I have an eighty-minute paper here, of which I cannot give you all, even with your consent. Some of it is so profound that I am

compelled to read it, because I don't understand it myself. Therefore, I couldn't tell it to you orally.

There was a certain professor at Amherst whose house caught fire, and the students thought they wouldn't have any American history afterwards because they thought his notes had burned. I need my notes, and so I am going to begin with my profound reading in getting back to some very elementary principles which Mr. McDowell forgot within a few years after I taught him.

BUSINESS TAXATION AND INTERSTATE COMMERCE

THOMAS REED POWELL

Harvard Law School

The law of state taxation of interstate commerce may be briefly stated. It says that the states may not tax interstate commerce. That seems simple enough for any one to understand. I don't see why a group of tax experts should ask a student of constitutional law to elaborate on it. To elaborate is necessarily to confuse. This is sometimes the result even in opinions of the supreme court of the United States. However much I may be able to confuse you, I suspect that I still must yield the palm to the learned justices. Their gift for adding confusion to confusion is not to be attributed to the fact that some of them are over the age of seventy. The confusion would not end if all the judges were young men barely old enough to join the Masons or the Knights of Columbus or some other fraternal or unfraternal organization. There is therefore no reason why I should enter into any discussion of recent suggestions for rejuvenating the judiciary. I will leave that topic to the leaders of the American bar. They know that it makes no difference who the judges are, because the judges have no real power. That is why these bar association leaders do not wish to swap judges when they are trying to keep from crossing a stream. The law is not made by the judges. Constitutional law does not come from the judges; it comes from the constitution.

Of course sometimes the constitution needs a little help in making itself fully articulate. It takes some one with very good ears to hear the constitution speaking on a good many matters because it has such a still small voice. Take this law of state taxation of interstate commerce that we are interested in. If you just looked at the words of the constitution, you wouldn't know that the states may not tax interstate commerce. The constitution doesn't say so in a voice loud enough for every one to hear. It says that the states may not impose duties on imports and exports, and so you might think that they might impose taxes on interstate commerce unless imports and exports are part of interstate commerce. The consti-

tution doesn't say whether they are or not. John Marshall evidently thought that they were.¹ But later Mr. Justice Miller and enough of his colleagues heard the constitution say that they weren't. That was in *Woodruff v. Parham*.² So the import and export clause doesn't forbid the states to tax interstate commerce. It must be some other clause that gives us the law that the states may not tax interstate commerce. The clause that gives us this law is the clause that says that congress shall have power to regulate interstate commerce. The judges who listened hard to this clause heard it whisper that the states may not tax interstate commerce.

Here is what the clause says to those who have sensitive ears to hear. When the clause says that congress shall have power to regulate interstate commerce, it is really saying that only congress shall have power to regulate the interstate commerce that only congress should regulate. The interstate commerce that only congress should regulate is that commerce that is national in character and so ought not to be regulated by the states. Over such commerce the power of congress is said to be exclusive. Such commerce includes interstate transportation and interstate trade. Therefore the states may not regulate interstate transportation and interstate trade. Of course, not everything that a state does to interstate commerce amounts to a regulation of it. Some state laws do not regulate interstate commerce but merely incidentally affect it. But taxation is regulation. Hence the states may not tax interstate commerce.

This is the way the constitution has spoken to some of the judges. Others have heard it say something different. They have heard it say that the power of congress over commerce is not exclusive. The constitution therefore does not forbid the states to regulate interstate commerce. It merely permits congress to do so and declares that congressional regulations are superior to state regulations. So a state regulation is not good if congress has already regulated what the state tries to regulate. Now congress has a wonderful power that only judges and lawyers know about. Congress has a power to keep silent. Congress can regulate interstate commerce just by not doing anything about it. Of course when congress keeps silent, it takes an expert to know what it means. But the judges are experts. They say that congress by keeping silent sometimes means that it is keeping silent and sometimes means that it is speaking. If congress keeps silent about the interstate commerce that is not national in character and that may just as well be regulated by the states, then congress is silently silent, and the states may regulate. But if congress keeps silent about the kind of commerce that is national in character and ought to be

¹ *Brown v. Maryland* (1827) 12 Wheat. 419, 449.

² (1869) 8 Wall. 123.

regulated only by congress, then congress is silently vocal and says that the commerce must be free from state regulation.

These two constitutional speakings have been reported from time to time by different justices and sometimes by the same justice in the same opinion. They cannot both be true unless the constitution says opposite things. It is one thing to say that the constitution says the states cannot regulate, and it is another thing to say that the constitution doesn't say so but merely lets congress say so if it wants to. Yet though these are very different things to say, they amount to the same thing in practice so long as congress never says anything. It wouldn't matter whether the courts were interpreting the constitution or interpreting the silence of congress, so long as you could be sure that congress would keep on keeping silent. But no one could be sure of anything like that. If congress should speak in a certain way after it had been silent, it might say the opposite of what its silence said to the supreme court it meant to say. This is just what happened about liquor. The court said that the states had to let outside liquor come inside them and be sold in the package it came in in. Now if it was the constitution that said that, only the constitution could say the opposite. But if it was just the silence of congress that said that, then congress could refrain from further silence and say the opposite by saying it out loud instead of silently. That is what congress did about liquor, and the court said that what congress said went, and that the states could now do what they couldn't do before.

Now all this talk had to do mostly, not with state taxation but with state police power, though the talk crept into the tax cases now and then. When congress still kept still, the court looked at the kind of interstate commerce the state was regulating to find out whether it could regulate it. But there isn't any case where the court looked at the kind of interstate commerce that the state was taxing to see if it could tax it. It couldn't tax any kind of interstate commerce if it got caught really doing it. There was a little while when I thought that the supreme court was going to have to say something different. The court had said that the states could fix the rates for some gas and electricity at the jet and socket although they got there in interstate commerce.³ I felt sure that the court would say, when it had to, that the state could also tax what those rates brought to the companies, and so I thought they might carry over that police power talk about national and local, uniformity and diversity, over into the tax cases. But they didn't. They let the states do the taxing, but they changed what they had said before about the gas and electricity still being in interstate commerce and they said that the original package got broken and the interstate commerce stopped, when the gas and electricity got

³ *Pennsylvania Gas Co. v. Public Service Comm.* (1920) 252 U. S. 23.

changed in some way so they could go into the houses without hurting them.⁴

So as we stand now, all interstate commerce is treated alike from the standpoint of state taxation, and the only question is whether it is really interstate commerce that is being taxed. If it is, it doesn't matter whether it is selling shoes or needles and pins or ginger ale or gasoline or carrying freight or passengers. There was a time when a ginger ale case⁵ went one way and a gasoline case⁶ went the opposite way, but the court merely got mixed up in its listening job for a while until it straightened itself out in the *Sonneborn* case.⁷ So we wouldn't be interested in what I have been talking about except for one thing. We would be very glad to know whether it is the silence of the constitution or the silence of congress that tells the court that the states may not tax interstate commerce. The court has never told us because it has never had to. Congress has always kept still about whether the states might tax some interstate commerce. So the court would still be free to say that, though it is the silence of congress and not the silence of the constitution that keeps the states from regulating some kinds of interstate commerce, it is the silence of the constitution and not the silence of congress that keeps the states from taxing all kinds of interstate commerce. I do not think that the court would say that, but it has never said the opposite unless you think that some state liquor taxes that were treated just like police regulations show that the court would treat all taxes in the same way.

Now for the rest of the time let us forget the puzzle of where this law really comes from, and just make believe that it comes from inside the supreme court even though the supreme court doesn't know it itself. We needn't care where the law comes from except for the one reason of wanting to know whether the court would let congress let the states have some taxes that the supreme court had said they couldn't have. Three years ago in Boston Mr. Lowndes and Mr. Rottschaefer disagreed about this,⁸ and we don't know any more about it now than they together did then. The question was raised because states with sales taxes wanted to find a way to have what we may call a purchase tax in addition to a sales tax. The buyer states thought it would be nice if they could get money from interstate sales and keep their sales taxes from inducing buyers to buy outside the state rather than inside. That was

⁴ *East Ohio Gas Co. v. Tax Comm.* (1931) 283 U. S. 465.

⁵ *Wagner v. City of Covington* (1919) 251 U. S. 95.

⁶ *Askren v. Continental Oil Co.* (1920) 252 U. S. 444.

⁷ *Sonneborn Bros. v. Cureton* (1923) 262 U. S. 506.

⁸ Lowndes, "State Taxation of Interstate Sales," *Proceedings of the Twenty-seventh Annual Conference of the National Tax Association* (1934) 139; Rottschaefer, "State Taxation of Interstate Sales," *ibid.* 149.

before the states knew what the still small voice of the constitution would say to the judicial Joans of Arc about use taxes. There was widespread apprehension that those voices would condemn the use of a use tax to make outside purchases yield a revenue to the buyer state. Now that this apprehension has been mollified, we are hearing less about congressional action to help state pocketbooks.

You may now wonder why there was any apprehension that the supreme court would not sustain the application of a use tax to goods after their introduction from another state. Such a tax on the use of gasoline was sustained in 1921 in the Bowman case⁹ while the court was still under the misapprehension about taxing sales in the original package.¹⁰ In 1932 Mr. Query won his case against the Gregg Dyeing Company,¹¹ although or because the court didn't care to hear his lawyers make an oral argument. What made for taxability here was storage for twenty-four hours for use or consumption within the state. The rate was the same as that imposed on sales, and Mr. Query couldn't get both a sales tax and a use tax on the same gasoline. He, however, got his storage tax without regard to any sales tax that the gasoline might have paid in another state, though in the particular case the Gregg Dyeing Company had made an interstate purchase so that they had not paid any sales tax. Technically, therefore, the question whether a use tax can be piled on to the sales tax of another state was not decided. It was, however, declared to be immaterial whether the sales and storage taxes were imposed by a single statute or by separate ones.

In the Edelman case¹² the next year there was no statement as to the mode by which the airplane company got their gasoline, i. e., whether by an interstate purchase or by an extra-state purchase. Here the tax was on sale or use. Withdrawal from tanks within the state was interpreted to be the "use" that was taxed, and such use was held taxable even though the next succeeding use was in airplanes engaged exclusively in interstate commerce. The mere use in such interstate commerce was held to be immune from state taxation in the Helson case¹³ in 1929, and this was followed in the Bingaman case¹⁴ in 1936. So really in the Edelman case it took storage to sustain the tax. The other cases show that the storage must be stationary storage outside of the tanks of a vehicle moving exclusively in interstate commerce. In the Wallace case¹⁵ in 1933 a railroad brought the gasoline into the state in tank cars. Nothing

⁹ Bowman v. Continental Oil Co., 256 U. S. 642.

¹⁰ Askren v. Continental Oil Co., *supra* note 6

¹¹ Gregg Dyeing Co. v. Query, 286 U. S. 472.

¹² Edelman v. Boeing Air Transport Co. (1933) 289 U. S. 249.

¹³ Helson and Randolph v. Kentucky, 279 U. S. 245.

¹⁴ Morf v. Bingaman, 298 U. S. 407.

¹⁵ Nashville, C. & St. L. Ry. v. Wallace, 288 U. S. 249.

is said about whether its extra-state purchase was by a local or an interstate sale or whether it had paid any tax elsewhere. The railroad took the gasoline from its tank cars and put it into stationary storage tanks before withdrawing it for use, so we do not know whether the constitution would be equally kind to the state if the tank cars were kept on sidings and the gasoline drawn out only as the railroad engines called for it.

At our Boston meeting in 1934 I expressed some doubts whether these gasoline cases would sanction a general compensatory use tax on all articles brought in from outside the state.¹⁶ It is not the greatest comfort to me to find from the *Henneford* case¹⁷ that my doubts were shared only by Justices McReynolds and Butler. No further secure solace comes from the possibility that there might have been more judicial doubters if the case had come to decision before some other members of the court learned to turn somersaults. Yet I still think that there is an important practical difference between storing for future withdrawal a quantity of gasoline in excess of immediate needs and wearing a pair of shoes bought from an outside mail-order house. These gasoline storers were in a practical sense local merchants to themselves as sole customers. They had something like a place of business more or less apart from the place of use. Knowing what fine distinctions the silence of the constitution or of congress is capable of drawing, I couldn't escape the possibility that a distinction might be drawn here.

Such a possibility seemed somewhat more likely from a statement of Mr. Justice Cardozo's in *Baldwin v. Seelig*¹⁸ in 1935. Here it was held that New York may not forbid the sale in New York of broken packages of milk purchased in Vermont at less than the price lawful for purchases in New York. The decision was readily distinguishable from the problem of a compensatory use tax, but early in the reasoning of the opinion Mr. Justice Cardozo said:

"Such a power, if exerted, will set a barrier to traffic between one state and another as effective as if customs duties, equal to the price differential, had been laid upon the thing transported."¹⁹

Now by "customs duties . . . upon the thing transported," Mr. Justice Cardozo doubtless meant duties upon introduction. But the effect of duties upon subsequent use would be just the same as that of duties upon introduction. The reference to a duty "equal to the price differential" shows that the tax hypothetically condemned was

¹⁶ *Proceedings of the Twenty-seventh Annual Conference of the National Tax Association* (1934) 156.

¹⁷ *Henneford v. Silas Mason Co.* (1937) 300 U. S. 577.

¹⁸ *Baldwin v. G. A. F. Seelig, Inc.*, 294 U. S. 511.

¹⁹ *Ibid.* at 521.

merely a "compensatory" one, i. e., one to safeguard against extra-state undercutting of local business when the undercutting was made possible by the action of the outside state in leaving sellers free to sell for as little as they wished. What is the difference between this and a compensatory use tax to safeguard against extra-state undercutting of local business made possible by the action of the outside state in leaving sellers free from the burden of a sales tax?

The analogue is close enough in the case of goods acquired by local purchases outside the state and brought in by the buyer. Is it any the less close in the case of interstate purchases, where the tax immunity comes not from the self-restraint of the selling state but from a judicially discovered constitutional command? And Mr. Justice Cardozo is still thinking about compensatory duties when he continues:

"Nice distinctions have been made at times between direct and indirect burdens. They are irrelevant when the avowed purpose of the obstruction, as well as its necessary tendency, is to suppress or mitigate the consequences of competition between the states. Such an obstruction is direct by the very terms of the hypothesis. We are reminded in the opinion below that a chief occasion of the commerce clauses was 'the mutual jealousies and aggressions of the states, taking form in customs barriers and other economic retaliation.' . . . If New York in order to promote the economic welfare of her farmers, may guard them against competition with the cheaper prices of Vermont, the door has been opened to rivalries and reprisals that were meant to be averted by subjecting commerce between the states to the power of the nation."²⁰

And again, after declaring that the breaking of the original package does not bring the New York statute constitutionally into play, he says:

"What is ultimate is the principle that one state in its dealings with another may not place itself in a position of economic isolation. Formulas and catchwords are subordinate to this overmastering requirement. Neither the power to tax nor the police power may be used by the state of destination with the aim and effect of establishing an economic barrier against competition with the products of another state or the labor of its residents. Restrictions so contrived are an unreasonable clog upon the mobility of commerce."²¹

Surely all this reference to tariffs could mean only that a tax to overcome the advantages of purchasing in Vermont would be as bad as a prohibition to overcome the advantage of purchasing in Ver-

²⁰ *Ibid.* at 522.

²¹ *Ibid.* at 527.

mont. Confining it to advantages derived from lower costs or from legal freedom of the seller to sell for what he will, it would mean that New York could not tax New York local sales of milk produced in Vermont in order to remove from the New York milk-dealer and the New York milk-drinker any temptation to prefer Vermont milk in order to escape from the consequences of the upset-price established for purchases from New York farmers. Unless later justices are to eat Mr. Justice Cardozo's words or to neglect them, the compensating use tax cannot be imposed to equalize other costs than tax costs. Of course a tax is a very different thing from a prohibition on sale. It is so different that there was no occasion for Mr. Justice Cardozo to talk about taxes in *Baldwin v. Seelig*.²² The fact that he chose to do so would at the time naturally lead to the inference that he wanted to lay a foundation for a later decision that a state may not by its taxing power seek to deprive goods from sister states of such competitive advantages as they enjoy because they were produced or sold there rather than in the destination state. With such language from Mr. Justice Cardozo in the New York-Vermont milk case, it was fitting that he should be asked to assume the burden of writing the opinion sustaining the Washington compensatory use tax.²³ In differentiating the earlier case he wisely neglected the language of his opinion therein. He confined himself to the difference in the facts. In the milk case, New York made outside lawful acts the basis of a New York prohibition. Mr. Justice Cardozo contrasts the two situations as follows:

"New York was attempting to project its legislation within the borders of another state by regulating the price to be paid in that state for milk acquired there. She said in effect to farmers in Vermont: your milk cannot be sold by dealers to whom you ship it in New York unless you sell it to them in Vermont at a price determined here. What Washington is saying to sellers beyond her borders is something very different. In substance what she says is this: you may ship your goods in such amounts and at such prices as you please, but the goods when used in Washington . . . will share an equal burden with goods that have been purchased here."²⁴

The difference is clear and substantial. But suppose New York had a tax to equalize local sales of New York and Vermont milk to protect New York farmers. New York then does not say to the Vermont farmers that their milk cannot be sold by New York dealers. It says to them only that their goods when sold in New

²² *Supra* note 18.

²³ *Henneford v. Silas Mason Co.*, *supra* note 17.

²⁴ *Ibid.* at 585.

York will bear a burden equal to the burden New York imposes on the sale of New York milk by the minimum price imposed on purchases from New York farmers. Is this so very different from the compensating use tax?

In the process of sustaining the Washington tax, Mr. Justice Cardozo notes that "one of its effects must be that retail sellers in Washington will be helped to compete upon terms of equality with retail dealers in other states who are exempt from a sales tax or any corresponding burden."²⁵ Change New York to Washington, Vermont to Oregon, and farmers to merchants and we can borrow from *Baldwin v. Seelig*²⁶ the sentence: "If Washington in order to promote the economic welfare of her merchants, may guard them against competition with the cheaper prices of Oregon, the door has been opened to rivalries and reprisals that were meant to be averted by subjecting commerce between the states to the power of the nation." And from the standpoint of this purpose, is it any better that Washington is, as Mr. Justice Cardozo notes, avoiding "the likelihood of a drain upon the revenues of the state, buyers being no longer tempted to place their orders in other states in the effort to escape the payment of the tax on local sales?"²⁷ Surely the Washington use tax cannot be good *because* its tendency is to protect the home market for the home merchant. It must be good in spite of that fact rather than because of it.

Yet how simple is the argument for the constitutionality of the use tax. Property cannot escape state taxation because it has an extra-state past. So if use taxes are as proper as property taxes, property used within the state should not escape a use tax because it has an extra-state past. Therefore the state must have power to tax the use of all property whatever its earlier origin. And if it may do this, it may accomplish the same result by putting on the equivalent of a use tax on local sales and putting the tax on use only on property that has not been taxed by Washington on its local sale. Here is complete equality of burden without regard to the pedigree of chattels. Washington does less than this when she says that she won't add a local use tax to an extra-state sales tax. Well, therefore, may Mr. Justice Cardozo praise Washington's clemency, and add that by such praise he does not mean to imply that the clemency was called for by the constitution. "A state," he says, "for many purposes, is to be reckoned as a self-contained unit, which may frame its own system of burdens and exemptions without heeding other systems elsewhere. If there are limits to that power, there is no need to mark them now."²⁸

²⁵ *Ibid.* at 581.

²⁶ *Supra* note 18.

²⁷ 300 U. S. at 581.

²⁸ *Ibid.* at 587.

Any effort to set limits to the power of a state to act as a self-contained unit will get the courts into innumerable difficulties. Certainly property taxes on real estate and on stocks of goods will never be compelled to allow a credit for extra-state taxes on the manufacture or sale of bricks and mortar and shoes and stockings in excess of corresponding taxes at the situs. Why should a use tax be asked to give credit for an extra-state fiscal past? If asked to make allowance for a prior extra-state sales tax, what about prior manufacturing taxes that may amount to substantially the same thing as a sales tax? States where skunks and muskrats are skinned, where oil and gas and coal and ore are brought to light, where electricity is generated and crops are grown and fruit is picked may impose levies at a point prior to sale. Except to a lawyer, a thorn by any other name may prick as hard. Washington may have done well to be kind to its users of property by remembering some past transaction that added to its cost, but to make such kindness constitutionally compulsory would result in adding more practical contradictions to a lot of law that is already adequately supplied with them.

With the use tax constitutional in its main feature, all that a use-tax state need worry about is the collection of it. Much of this worry is of no concern to a lawyer. It is for the practical man to find the way to find the stoves and shoes and blankets and bananas and oranges that come to use or consumption after a direct interstate journey. If there were no other objection, an army of snoopers could hardly make its snooping pay. Snoopers after liquor did not meet with unqualified and universal success. Hence our practical men in the use-tax states are seeking some substitutes for snooping in legal devices that the courts will be called upon to sanction or condemn. One of them seems good enough to pass judicial muster. A high registration fee for motor vehicles may allow deduction for sales taxes already paid. This is a North Carolina contribution. Iowa has copied it and added an appendage. Users of gasoline in farm tractors, airplanes, motor boats and stationary engines are allowed a refund of the gasoline tax, but only upon showing that the vehicle has not escaped from a sales tax or a use tax. Iowa has not extended this to the sower or reaper that the tractor pulls. This plan conditions the grant of a favor upon proof of compliance with a demand. It seems constitutional enough, but more cumbersome and perhaps no more remunerative than simply denying the favor.

Another collection device which has been adopted by some states is to require all retailers maintaining a place of business within the state to collect a use tax upon all property sold by them for use within the state even though the sale is not made from a place of business within the state. As an initial proposition I should regard

this as extremely questionable, but the Monomotor Oil case²⁹ without citation of authority settles it in favor of the state, at least with respect to interstate purchases negotiated within the state by vendors engaged also in local commerce within the state. I have heard, however, that there are efforts by state officials to construe the words "retailer" and "place of business" to cover agencies within the state which confine themselves to the solicitation of interstate purchases. This raises grave constitutional issues of two sorts, of which the solution is still in the womb of constitutional silence. The first is whether the duty to act as tax collector can be imposed upon a concern engaged exclusively in interstate commerce. The second has to do with the methods by which such a duty can be practically enforced.

On the power to impose on a concern engaged exclusively in interstate commerce the duty to serve as a collector of a use tax, it is clear that such an imposition, to be constitutional at all, must be intrinsically constitutional, since the state grants no privilege to which the duty might be attached as a condition. But the old law that intrinsically unconstitutional conditions might be imposed as the price of a privilege is now pretty thoroughly dead, wherever the condition is in itself a burden on interstate commerce or a projection of state power beyond its borders. Therefore it would seem that in the Monomotor case³⁰ it could not be essential that the company enjoyed the privilege of engaging in local commerce. Mr. Justice Roberts makes no mention of local commerce or of negotiations within the state when he affirms broadly that "the requirement that the appellant as the shipper into Iowa shall, as agent of the state, report and pay the tax on the gasoline thus coming into the state for use by others on whom the tax falls, imposes no unconstitutional burden either upon interstate commerce or upon the appellant."³¹

We all know the danger of taking general language out of its setting in the particular case in which it is used. Yet it would have been simple for Mr. Justice Roberts to have confined his declaration explicitly to concerns engaged partly in local commerce or to interstate commerce resulting from negotiations within the state. Was it design or inadvertence that he did not do so? You can guess as well as I. Nobody dissented in the case and nobody confined concurrence to the result. The burden on interstate commerce comes from the tax which in effect deprives interstate sales of the advantage of their constitutional immunity. That burden is the same whether the concern that is made the tax collector is doing local commerce in addition or not. Any question of extra-territoriality is the same whether the tax collector confines himself to interstate

²⁹ Monomotor Oil Co. v. Johnson (1934) 292 U. S. 86.

³⁰ *Supra* note 29.

³¹ 292 U. S. at 95.

commerce or not. It is, however, not quite the same whether the tax collector has negotiated the sale within the state or not. But if the court thought this really important, it was a grave neglect not to mention it in the *Monomotor* case. All signs point to the conclusion that the supreme court is ready to help the use tax work as well as it can until modes of collection run afoul of some clear constitutional canons.

An insurance company cannot be excluded from the state because outside the state it pays commissions to agents securing policies on lives or property within the state.³² A privilege that may be denied for no reason may not be denied because of extra-territorial conduct that does not project itself into the state. No such projection is found in issuing policies or paying commissions on policies outside the state on persons or property within the state. This is not interstate commerce law. It is due process law. The interstate commerce law must be stricter still. I should have expected the court to say that shipments into the state cannot be made the basis of a duty to pay a use tax on behalf of the consignee. True the shipper projects his conduct into the state more than does the insurance company which outside the state issues policies on property within the state, but this projection is in interstate commerce. If the orders are solicited within the state, there is more projection still, but the solicitation is interstate commerce that cannot be forbidden or taxed. To my mind from a practical standpoint the court has swallowed the camel in the *Monomotor* case, and I should not expect it to strain at gnats.

We are still thinking about the power to impose the duty to pay and not the power with respect to any particular modes of collection. Where there is a soliciting agent within the state, the door is open to evasion if the duty to pay can be imposed only when the agent has solicited the particular consignment to be used. One order obtained by the resident agent may be followed by others solicited from outside with the lure of a lower price if the vendor is not bound to pay a use tax. With the agent within the state compelled to make reports on consignments he induces, he must know the demand of the statute and report it to his principal who will be amply warned to make his price cover the use tax on all consignments shipped into the state. It is no more bother to pay on all than on those the agent negotiated. The tax is a valid tax in all cases. All we are concerned with is the duty of the shipper to pay it on behalf of his consignee. The shipper should be protected so that he can recoup himself from the consignee, if he wishes, by raising the price. This much would seem to be essential in order to maintain the fiction that the tax is on the use and not on the

³² *Fidelity & Deposit Co. v. Tafoya* (1926) 270 U. S. 426.

sale. For this the established enterprise of the agent within the state should be enough.

The menace of competition from extra-state and interstate untaxed sales is not fully guarded against unless the burden of collecting a use tax can be put on vendors who have no soliciting agent or place of business within the state. An outside concern may have a solicitor within the state to secure initial customers who will continue for years to give orders long after the abandonment of any agency in the state. Mail-order houses with no local retail stores may flourish in the future as they have in the past. And desiring persons may make brief migrations to other states for cash-and-carry purchases as they do for cash-and-carry divorces. Extra-state vendors to the cash-and-carry customers would have to be mind-readers or intrusive inquisitors to discover their intentions as to future use. Extra-state vendors who ship into the state do not because of that become subject to the jurisdiction even to aid in the collection of a lawful tax. They are not subject to the jurisdiction of the courts of the state. In the absence of unprecedented judicial somersaults, the state must forget about them and hope to catch their vendees.

Now as to modes of collection. A foreign corporation doing business in a state through a regular agency is subject to suit therein by service on the agent, though the business is exclusively interstate commerce.³³ Whether the same is true of individual citizens of another state with an agent in the state confining himself exclusively to interstate commerce we do not know. In the Doherty case,³⁴ the commerce clause was not mentioned, and the opinion was careful to state that the business of selling securities is exceptional. We shall know when we shall know. The Harvester case³⁵ in allowing suit against foreign corporations engaged exclusively in interstate commerce shows that doing business is enough even though the business could not be forbidden. This does away with the necessity of showing a situation in which the state can invoke the "implied consent" fiction. There would seem to be no sensible reason why an individual citizen of another state should be treated more favorably than a foreign corporation.

When the judgment is obtained, it is entitled to full faith and credit in the courts of another state. *Milwaukee County v. White Co.*³⁶ told us so less than two years ago. That involved a judgment for a tax lawfully imposed on the defendant foreign corporation. The fact that in the use-tax situation, the notion is that the vendor is merely made a collector of a tax on the vendee's use could hardly

³³ *International Harvester Co. v. Kentucky* (1914) 234 U. S. 579.

³⁴ *Henry L. Doherty & Co. v. Goodman* (1935) 294 U. S. 623.

³⁵ *Supra* note 33.

³⁶ *Milwaukee County v. M. E. White Co.* (1935) 296 U. S. 268.

be material once a valid judgment has been obtained. Would it be material if the suit in the sister state is not on a judgment but on the original liability? In the Milwaukee County case,³⁷ Mr. Justice Stone notes that such suits for tax liabilities have been entertained by courts of sister states without regard to any compulsion of the full faith and credit clause, and he states that whether such suits must be entertained is an open question in the supreme court. If ultimately the suit on the liability should be given the same consideration as a suit on a judgment therefor, it is again hard to see any reason to make a distinction between a liability as a vendor collector and one as a vendee user or as any one else who owes a tax imposed primarily on himself rather than on another.

One other problem of collection deserves mention. May a state apply to foreign corporations engaged exclusively in interstate commerce within the state the device whereby suits arising out of the business there done may be begun by service of process on the secretary of state after the corporation has withdrawn from the state? Such a requirement cannot be imposed as a condition of doing business or of bringing suit.³⁸ The imposition of the duty to appoint an agent was condemned when it was assumed that this would involve subjection to suit on causes of action whatever their origin. But it is still an open question whether the automobile type of statute applied in *Hess v. Pawloski*³⁹ can be applied to a foreign corporation engaged exclusively in interstate commerce. Unless the question is answered in the affirmative, or unless suits on liability are permitted in other states, many vendors may escape suit for use taxes for which the liability is without question.

At best the use-tax device is a cumbersome and imperfect one. It is a flimsy fiction that the vendor is not paying a sales tax on interstate sales. A court that willingly swallows such a flimsy fiction must be persuaded that the immunity of interstate sales involves practical undesirabilities that deserve to be curtailed or diminished. Such a view explains for me the otherwise inexplicable Wiloil case.⁴⁰ Under all the law I knew before, if a corporation made such a sale as those there involved, it could not have been punished for doing business without a license. In the Robbins case⁴¹ and all that followed, it was never considered whether the contract might not have been fulfilled by shipments from within the state. It was enough that it was not. The Wiloil case⁴² may

³⁷ *Supra* note 36.

³⁸ *International Textbook Co. v. Pigg* (1910) 217 U. S. 91; *Sioux Remedy Co. v. Cope* (1914) 235 U. S. 197.

³⁹ (1927) 274 U. S. 352.

⁴⁰ *Wiloil Corp. v. Pennsylvania* (1935) 294 U. S. 169.

⁴¹ *Robbins v. Shelby County Taxing Dist.* (1887) 120 U. S. 489.

⁴² *Supra* note 40.

mean that the court is ready to be more tolerant toward sales taxes than toward occupation taxes. It might have been influenced by the fact that gasoline was involved or by the fact that the Wiloil people seemed to be rather cute in drawing up their contracts. The Monomotor case ⁴³ may have been influenced by the fraud that had been practiced. I should have expected both cases to go the other way, and should not have been surprised had the Henneford case ⁴⁴ gone the other way. So for my own technical self-respect, I am compelled to believe that there has been a shift in the judicial attitude.

There is a material practical difference between requiring a license, with payment of a specific tax therefor, from an agent of an outside house before he may begin to solicit orders and applying a general sales tax to sales consummated by shipments from without the state. The first tends to deter solicitation of interstate purchases. The second, considered alone, merely puts interstate sales on a parity with local sales. If all sales from stock within the state may be taxed, provided the goods are not within the protection of the import clause, there is no economic reason why all sales to persons within the state should not be treated alike. The supreme court must agree, or it could not have decided the Wiloil,⁴⁵ Henneford ⁴⁶ and Monomotor cases ⁴⁷ the way it did. The difficulty arises from what we leave out of consideration when we confine ourselves to the sales tax "considered alone." The omission, of course, is of burdens that may be put on the interstate transaction or its antecedents by the state of origin. Interstate sales would not be on a parity with intrastate sales if they might be taxed by the state of origin as well as by the state of destination.

The use-tax method of practical evasion of previously understood commerce-clause immunities has thus far been attempted only by states of destination. Suppose the state of origin seeks to put on a use tax or storage tax or withdrawal tax to reach thereby all withdrawals for interstate shipment. If this were sanctioned, then interstate sales would in substance be exposed to two taxes where local sales are exposed to but one. So far as anything doctrinal is concerned, it is as simple to sustain a tax on withdrawal for shipment in interstate commerce as a tax on withdrawal for use as fuel for airplanes flying exclusively in interstate commerce.⁴⁸ Nor is a tax on such withdrawal, considered by itself, and more of a burden on interstate commerce than a tax on manufacture when applied to

⁴³ *Supra* note 29.

⁴⁴ *Supra* note 17.

⁴⁵ *Supra* note 40.

⁴⁶ *Supra* note 17.

⁴⁷ *Supra* note 29.

⁴⁸ *Edelman v. Boeing Air Transport Co.*, *supra* note 12.

goods destined for other states. But the goods thus withdrawn would be subject to a tax on their manufacture, either in the vendor state, or in some other state in which they were previously produced. Hence if the supreme court is to allow the state of ultimate use to impose a tax which is in effect on the interstate sale, it should be cautious in sanctioning a new corresponding tax by the state from which the goods are shipped. The use, storage and withdrawal notions ought to be confined to taxes by the state of destination in order to prevent heavier burdens on interstate commerce than on local commerce.

Perhaps it is safe to assume that states of origin will not be disposed to put undue burdens on their commerce with other states. They can reach production, extraction and manufacture by taxes thereon. They can hardly wish to discourage mercantile transactions with other states. They have no need for the self-protection that animates the use-tax device in states of destination. The more their mercantile establishments profit, the more revenue they can get by income taxes and property taxes. Only when they think they have an assured market in other states, as Pennsylvania thought, though mistakenly, with respect to anthracite,⁴⁹ are they likely to burden their wholesalers and retailers in their trade with extra-state customers. So the danger of bi-state double burdens which are in substance, though not in form, on interstate sales may not be ominous. Yet its possibility should be considered by judicial statesmen in determining how far to go in saving states of destination from economic disadvantages hitherto assumed to be incident to the immunities enjoyed by interstate sales.

There is no good reason why interstate commerce should be wholly immune from state taxation. There is very good reason why interstate commerce should be safeguarded against discriminatory taxation and against bi-state double taxation. Many of the cases that have condemned license or occupation taxes have involved selective fiscal demands that did not fall on all enterprise and that might therefore be part of a scheme to favor some local business at the expense of some interstate business. Such selective demands if sanctioned in the state of destination might well secure similar sanction in the state of origin. To prevent double taxation it has often been necessary to confer complete immunity. A state tax on an interstate sale is in part a tax on extra-territorial enterprise. It is hard to see any economic difference when an extra-state vendor is made to pay a so-called use tax on behalf of his vendee. To sustain such a tax in common sense, we should either justify the extra-territoriality or insist on safeguards against bi-state duplication of burdens. The supreme court may give to the states more freedom than they ought to exercise. There is room for considering what

⁴⁹ *Heisler v. Thomas Colliery Co.* (1922) 260 U. S. 245.

the states ought to do within the confines of what the supreme court may permit them to do.

One question concerning sales taxes in the state of origin may deserve mention in anticipation of supreme court consideration. Suppose delivery is to the vendee's trucks for immediate carriage to his place of use in another state. This in economics is as much an interstate sale as when delivery to the buyer's state is by the vendor or by common carrier. Transactions less substantially interstate than this have been held to be immune from the police power of the state of origin in the Dahnke-Walker case⁵⁰ and the Farmers Grain case.⁵¹ Those decisions seemed to me at the time to be completely novel. I explain them now because they were police power cases. In the state of destination the police power must keep farther away from the interstate transaction than need the taxing power.⁵² So it may be that in the state of origin, antecedents of interstate commerce may need protection from police power though not from taxing power. Therefore I do not believe that these two police power cases forbid state taxation of deliveries within the state for immediate shipment outside. On the other hand, I do not believe that the Superior Oil case⁵³ necessarily sanctions state taxation of such sales. That is one of the cases that I call "you-think-you're-smart cases." The taxpayer tried to be cute and failed to get away with it.

*Spalding Brothers v. Edwards*⁵⁴ has always been a hard case for me to line up with its predecessors. Here there were two sales with delivery telescoped. Spalding sold to an American commission firm to fill their order from a South American retailer and put the goods on a boat for South America. The Spalding sale was held to be a sale for export. Clearly the commission firm's sale was a sale for export, so out of this transaction there were two sales for export. It seems a little miraculous. I think that I can see a good reason for the decision in that the intermediary American commission house is an essential instrumentality in furthering purchases from foreign firms, and the explicit prohibition of any duty on exports may disregard technicalities and see to it that the intervention of an essential intermediary does not permit congress or the states to put a crimp on our foreign trade. The case from this standpoint is like those condemning stamp taxes on charter parties,⁵⁵ bills of lading⁵⁶ and marine insurance policies⁵⁷ when these are necessary commercial

⁵⁰ Dahnke-Walker Milling Co. v. Bondurant (1921) 257 U. S. 282.

⁵¹ Lemke v. Farmers Grain Co. (1922) 258 U. S. 50.

⁵² Cf. Leisy v. Hardin (1890) 135 U. S. 100 with Woodruff v. Parham, *supra* note 2.

⁵³ Superior Oil Co. v. Mississippi (1930) 280 U. S. 390.

⁵⁴ A. G. Spalding & Bros. v. Edwards (1923) 262 U. S. 66.

⁵⁵ United States v. Hvoslef (1915) 237 U. S. 1.

⁵⁶ Fairbank v. United States (1901) 181 U. S. 283.

⁵⁷ Thames & Mersey Marine Ins. Co. v. United States (1915) 237 U. S. 19.

instruments for the export trade. Nevertheless I should discount the decision as a sure index of what is an interstate sale.

I had always assumed that the Banker Brothers case⁵⁸ would have gone the same way if the Pierce Arrow people had made delivery direct to the customer of Banker Brothers. So I have assumed that if I order a book from a local book store and they have the extra-state publisher send it to me by mail, there have been two sales with delivery telescoped, and my purchase is a local one and taxable. Clearly the extra-state publisher makes an interstate sale and would be immune from a gross receipts tax.⁵⁹ The fact that he delivers it to the customer of his vendee rather than to the vendee can make no difference, since the state-line straddle is the same in either case. But what about the local book store? His books would show a payment by him to an extra-state concern and a receipt by him from a local customer. He makes a local sale much more clearly than the Wiloil people did. Yet he is in the same situation in the state of destination that the commission house in *Spalding v. Edwards*⁶⁰ was in the state of origin. It will be simple enough for the supreme court to decide my book-store case either way, but not so simple to distinguish the precedents adduced by the lawyer who is to lose.

To return to the purchaser who accepts delivery and carries his purchase to his place of business in another state, would the supreme court hold that the North Dakota farmers who sold their grain to the North Dakota elevator made an interstate sale because the elevator habitually shipped the grain immediately to Minnesota? There would be no new anomaly in saying that the decision that the commerce clause prevents North Dakota from fixing the price does not mean that the commerce clause prevents North Dakota from taxing the sale, for this anomaly, if anomaly it is, finds its counterpart in the law as to state taxation and state police power in the state of destination. I am betting that in my case the supreme court will permit state taxation and invoke the Superior Oil case.⁶¹ If it doesn't, it will get into many difficulties when New Jerseyites carry their parcels home with them from Manhattan. It will invite numerous squabbles about proof as to what the customer in fact did after the seller saw the last of him. These are the chief reasons for my bet. Whether I would bet that I will win my bet is another question.

The reason for our difficulties in prophesying what the future law will be in this field is part and parcel of the age-old struggle between form and substance. Sometimes the supreme court disregards sub-

⁵⁸ Banker Bros. Co. v. Pennsylvania (1911) 222 U. S. 210.

⁵⁹ Heyman v. Hays (1915) 236 U. S. 178; Crew Levick Co. v. Pennsylvania (1917) 245 U. S. 292.

⁶⁰ *Supra* note 54.

⁶¹ *Supra* note 53.

stance and cleaves to form and sometimes it disregards form and cleaves to substance. Almost without exception it insists that a tax must be formally correct, i. e., that it must in language be imposed upon a taxable subject. At one time this seemed to be sufficient, and the court allowed a tax formally on a taxable subject to be measured by other subjects that would not themselves be proper subjects to name as the subject of the tax.⁶² The Western Union case⁶³ in 1910 announced a change of judicial heart. The vice in statute there condemned was the inclusion in the assessment of extra-territorial values. Such vices have ever since been condemned. Such vices, we all must agree, are substantial vices and not mere formal ones. A question not yet clearly settled, however, is whether a tax formally on a proper subject is to be held bad merely because the measure adopted could not itself be made the subject of a tax.

Long before the Western Union case,⁶⁴ *Ficklen v. Shelby County*⁶⁵ allowed an excise on doing local business to be measured by gross receipts from all business done within the state. This case has never been overruled. It has been followed by *American Manufacturing Co. v. St. Louis*⁶⁶ which sanctioned a license tax on manufacturers of one dollar for each \$1000 worth of sales with no deduction for the fact that some of the sales were interstate and some were extra-state. It was found to be a fact, whether rightly or wrongly, that the tax was no larger because measured by such sales than it would have been if measured by value at the factory. It was noted that it was a convenience to the taxpayer to postpone payment until sales were made. The Ficklen case⁶⁷ was not cited. There was the usual talk of the burden being indirect and incidental rather than direct. The opinion carries the flavor of what is known as the servant girl's reason. Had the decision gone the other way, it would be a simple matter for St. Louis to change the ordinance and put a higher rate on the value of the goods at the time of manufacture. And so the case stands as a refusal to apply to gross receipts from interstate commerce the condemnation of the measure of extra-territorial values.

This decision was the one I found most troublesome when I was working on a brief against a tax on the extraction of oil and gas measured by gross receipts from sales which were all interstate. The state court kindly re-wrote the statute and said that the interstate receipts were to be looked at only to find the value at the well.

⁶² *Railroad Co. v. Maryland* (1875) 21 Wall. 456; *Maine v. Grand Trunk Ry. Co.* (1891) 142 U. S. 217; *Allen v. Pullman's Palace Car Co.* (1903) 191 U. S. 171.

⁶³ *Western Union Telegraph Co. v. Kansas*, 216 U. S. 1.

⁶⁴ *Supra* note 63.

⁶⁵ *Ficklen v. Shelby County Taxing Dist.* (1892) 145 U. S. 1.

⁶⁶ *American Mfg. Co. v. City of St. Louis* (1919) 250 U. S. 459.

⁶⁷ *Supra* note 65.

It suggested that the way to find value at the well was to subtract from the gross receipts the cost of transportation. The case then went to the supreme court at that stage, and the supreme court held in *Hope Natural Gas Co. v. Hall*⁶⁸ that it was proper to compute the tax upon value at the well, and that if executive officers should later fix values upon some inappropriate basis then there might be appropriate relief. One cannot tell from the supreme court opinion what would have been the result had the state court invoked the Ficklen Case⁶⁹ and held that gross receipts from interstate sales may be the measure of a tax on extraction. By helping to persuade the state court to declare the opposite, I lost a needed opportunity to learn some law that I had been anxious to know. The cause fell by the intellectual wayside because the parties settled it.

Next came our non-litigious friend Holcomb's fight against a New Jersey excise that purported to be a tax on the franchise of using or occupying the public streets measured by the gross receipts allocated thereto.⁷⁰ In so far as the gross receipts came from intra-state commerce, the company did not object, though it learned from Mr. Justice Butler that the rule of allocation adopted was totally unsuited to the determination of the value of the franchise to use the streets. This unsuitability seemed to be the main reason why the majority held that the tax was not on such a special franchise but on the gross receipts themselves. So the case went on the ground that the state had not succeeded in picking a proper subject, and we therefore got no direct light on whether a tax on a proper subject may be measured by gross receipts from interstate commerce. The majority of the court worked valiantly to decide the case for Mr. Holcomb without getting into the issue still left open by the Ficklen case⁷¹ and the American Manufacturing case.⁷² This made it clear enough that those two cases were not cherished landmarks to the then majority of the court.

The next chance to get light seemed to open in the Anglo-Chilean Nitrate case,⁷³ but here again direct light was withheld. The measure here was property immune from direct taxation because it consisted of imports still in the original packages under the rule of *Brown v. Maryland*.⁷⁴ Had the goods come from another state, they would be taxable. It is hard to think of any common-sense reason why they should not pay their way, whether from a sister state or from abroad. The vice in the measure here was a merely formal one, substantially quite different from the assessment of extra-terri-

⁶⁸ (1927) 274 U. S. 284.

⁶⁹ *Supra* note 65.

⁷⁰ *New Jersey Bell Tel. Co. v. State Board of Taxes* (1930) 280 U. S. 338.

⁷¹ *Supra* note 65.

⁷² *Supra* note 66.

⁷³ *Anglo-Chilean Nitrate Sales Corp. v. Alabama* (1933) 288 U. S. 218.

⁷⁴ *Supra* note 1.

torial values. The court, however, did not get to the question whether the property that could not be the subject of a tax could be used as the measure of a tax on a proper subject. It found on the basis of its interpretation of involved opinions from the state court that the tax was not on the privilege of doing local business, which the company possessed but did not exercise, but was on the doing of business and hence was unconstitutional when the business was confined to the sale of imports. Hence again the Ficklen case⁷⁵ was left standing but with nothing to comfort its weak hold on the affections of the court.

The supreme court like the congress may speak by silence as well as by speech. It may be no more precarious to interpret its silence than to interpret its speech. In the Nitrate case,⁷⁶ it would have been simple to hold with the minority that the tax was levied on the subject of the privilege of doing local commerce which the company possessed, measured by the capital employed within the state. The state opinions may well have meant only that no capital was to be used in the assessment unless it was *employed* within the state, i. e., that the company, though taxable because of the unexercised privilege of doing local business, was not to be assessed on idle capital within the state. This was the view of the minority. If the majority doubted, they might have sent the case back to the state court. Clearly there was room for doubt. Clearly also it seems to me that the majority wished to avoid the direct issue of the Ficklen case⁷⁷ and to reach a decision that might be later cited as a precedent against the Ficklen case. Ever since 1910 I have wanted to know whether the Ficklen case is still law. It seems pretty cruel of the supreme court to keep in ignorance for twenty-seven years a law professor who is sadly in need of all the knowledge he can get.

In closing I want to tie the use-tax cases and the franchise-tax cases together to reinforce a suggestion I made at one of our earlier gatherings.⁷⁸ The Alpha Portland Cement case⁷⁹ still irks me. If a bad measure may defeat a tax on a good subject, I do not see why a good measure may not sanctify a tax on a bad subject. The supreme court, however, declares otherwise, and we must bow in reverence. Nevertheless I still feel that there is some economic merit to the complaint made by the Matson Navigation Company⁸⁰ that its net income from interstate commerce was included in the

⁷⁵ *Supra* note 65.

⁷⁶ *Supra* note 73.

⁷⁷ *Supra* note 65.

⁷⁸ "Business Taxes and the Federal Constitution," *Proceedings of the Eighteenth Annual Conference of the National Tax Association* (1925), 164.

⁷⁹ *Alpha Portland Cement Co. v. Massachusetts* (1925) 268 U. S. 203.

⁸⁰ *Matson Navigation Co. v. State Board of Equalization* (1936) 297 U. S. 441.

assessment of its franchise tax although under the statute companies engaged exclusively in interstate commerce would bear no corresponding burden. I agree with Mr. Justice Butler that "the submission by the state to the commerce clause cannot be held to violate the equal protection clause."⁸¹ I would salve the navigation company's sore, not by exempting them, but by seeking a way to impose corresponding burdens on their competitors. I would seek to do this by imposing a direct income tax on the net income earned within the state by all concerns engaged exclusively in interstate commerce. This would match the excise tax measured by net income and ensure the equality that is desirable.

The use-tax cases⁸² and the cases on motor vehicles using the highways for hire in interstate commerce⁸³ show that a tax is not discriminatory against interstate commerce if other taxes impose equal burdens on local commerce. I assume that net income from interstate commerce within the state is a proper subject of state taxation. There is no case that tells me this, but no case tells me the opposite. Clearly enough property cannot escape a property tax because the property is used exclusively in interstate commerce.⁸⁴ With the simile of the tree and the fruit, income taxes were likened to property taxes in the Oak Creek case.⁸⁵ I should be shocked beyond words if the court should hold that a tax *on* net income must keep away from a concern engaged exclusively in interstate commerce. Certainly if there are concerns that escape from taxation under the Alpha Portland case,⁸⁶ the states should seek to overcome that case by a direct tax on net income. I refrain from repeating my earlier suggestion⁸⁷ that the statute should say that there is hereby imposed an excise on doing business measured by net income or a direct tax on net income depending upon which would make the

⁸¹ 297 U. S. at 446.

⁸² Gregg Dyeing Co. v. Query, *supra* note 11.

⁸³ Interstate Busses Corp. v. Blodgett (1928) 276 U. S. 245.

⁸⁴ Here again no case, so far as I can recall, tells me this, but no case tells me the opposite. Apparently no one has resisted a property tax on the ground that the property was employed exclusively in interstate commerce. I long assumed that *Henderson Bridge Co. v. Kentucky* (1897) 166 U. S. 150, which sustained an assessment on an interstate bridge which included an excess over the physical value, necessarily involved a holding that a property tax may be imposed on property employed exclusively in interstate commerce; but recently *Detroit International Bridge Co. v. Michigan* (1935) 294 U. S. 83, came along with the surprising information that a company owning and operating an international bridge is not engaged in foreign commerce but merely in furnishing a facility for such commerce. If the company added a moving platform which saved people from moving under their own power, the result might be different from the standpoint of an excise tax, but I am confident that it would make no difference from the standpoint of a property tax.

⁸⁵ United States Glue Co. v. Town of Oak Creek (1918) 247 U. S. 321.

⁸⁶ *Supra* note 79.

tax more palatable to the supreme court in each particular case, but I should, in view of the use-tax cases, seek a politer way of achieving the desired result.

CHAIRMAN TOBIN: I am sure we are all indebted to Professor Powell for his fine paper. We are always glad to have him come, and hope that he will come back soon again and be a part and parcel of us.

It just so happens that one of his students preceded him and one of his students will come after him.

It is with great pleasure that I introduce a neighbor—at least he was a neighbor, coming from Troy, New York, which is just a short distance from my home—who will now take up the subject of Professor Powell's paper, Mr. McDowell, of New York City.

M. E. McDOWELL (New York): Chairman Tobin, President Leser, Professor "Tommie," Ladies and Gentlemen of the conference: Behold at long last an amazing thing on this program, or on these programs so far, a representative of the taxpayer. I am not sure that that means very much, because I have attended hearings of the house ways and means committee and of the senate finance committee over a number of years past, and it has begun to be borne in on me that the taxpayer is about the least important and least wanted individual on discussions of taxation. I had always assumed that he occupied a rather important place, but even at the last session of congress they paid more attention to a Dutch economist from Holland with an Oxfordian accent, in so far as the laws affecting non-resident aliens were concerned, than they did to the president of a hard-pressed furniture manufacturing company in Virginia who had something really to kick about in the undistributed profits tax.

As a representative of the taxpayer I am abashed at the aggregate of the technical erudition of this group. I am also a little bit floored by the legal excellence, as always, and the analytical precision of the paper that we have just heard and that I am supposed to discuss. So in order to allow me just a moment to get my platform legs and to allow you just a moment of relaxation from the intense type of attention that Dr. Powell's papers always command, I am going to relax just a bit and tell you just why I am here.

When the invitation came I am quite sure that the program committee knew nothing of the student-professorial relationship that I had with Dr. Powell, and I am quite sure that he didn't remember it at the time. It is a rare opportunity for a student to come, even after a wait of sixteen years, to get a crack at the old professor.

I am going to tell you about that. Sixteen years ago when Professor Powell had a small class in constitutional law he introduced

⁸⁷ *Op. cit.*, *supra* note 78, at pp. 176-177.

me to the vagaries of the interstate commerce problems in the hottest room, at the top of the law school on Columbia's Morningside Heights, in New York. There were a few of us who had been forced by conflicts of arrangements to take that course in the summer time, and then there were a few political science students who came over because they needed three hours.

MR. POWELL: Some of them took it the second time. I don't know whether you were one or not. They liked it so much.

MR. McDOWELL: The only sin Professor Powell committed was in the perpetual wearing that summer of a pink shirt, and the summer was so hot that he couldn't keep his coat and vest on, so he paraded in all the glory of that pink shirt through the vagaries of constitutional law. He finally got to the point where he covered the blackboard from this side of the room (indicating) to that completely around with a running railroad track. He had a company domiciled in one state and its principal operating officers in another state. Then he had some timber land in a third state from which it made railroad ties, then it carried those railroad ties into a fourth state to a creosoting plant, and then it took those ties to a storage place in a fifth state, then it put some of the ties in a track in a sixth state. By that time he ran out of blackboard and out of that setup he built up all the tremendous problems in both police power and taxation that can arise under interstate commerce complications.

After the class I remember that two of the men and myself went up to talk to him and we said, "Now right here at this point, at this creosoting plant, we have read a case that might just as well mean that the law of taxing the particular business carried on there might have been the other way around." Then we quoted the case.

He looked around rather furtively and he said, "You gentlemen are under the law faculty, aren't you?"

We said, "Yes."

"You are quite sure," he said, "that there are none of those political science people around here, because they wouldn't understand what I am about to say to you? The way you have described that problem is the way I teach it in each alternate year."

Then for the next half hour I heard one of these delightful commentations on the conflict of judicial opinion, especially as expressed by the supreme court, in the same way in which he has brought to us those conflicting statements of Justice Cardozo in these two cases tonight, and the confusion that exists at the present time.

The kind of a paper that Professor Powell has given us tonight—and this is true even of the early part where he goes into the metaphysics of vocal silences and silent silences which amused you so much—isn't the kind of a paper that can be discussed or commented upon. I have had his paper, and I know how much of it he unfortunately left out here, and I tell you that the only way to get the good

out of even that earlier portion of the paper is to get the old slippers and pipe and get off in the chair in the corner and read it about three times. Then the smiles at the freshness of verbiage will disappear and you will begin to see what a really fine exposition of the confusion of judicial thought, as it has reached what seems to me to be a high point at the present time, it is.

So it seemed to me that rather, in the few remarks that I have to make in discussing Professor Powell's paper, I could take what he admits in announcing his subject at the outset to be one of the confusions inherent in the examination of these decisions, and add a little more confusion perhaps by trying to orient this confusion of legal and judicial thinking on the subject into the practical fact picture as a taxpayer who is doing interstate business sees it.

To me there is not only confusion, but there is added to that confusion a certain amount of frustration. The decisions, as far as I am concerned in dealing with the business problems of companies doing interstate business, haven't gone far enough yet to guide me in my current problems. My active problems of a business that is going on every day, day after day, are way out ahead of the decisions that would guide me in the most advantageous tax setup for that kind of a business.

The best example that I can give you as a practical matter is the fact that we all had pretty well lulled ourselves to rest when the doctrine of the *Farmers' Loan & Trust Company v. Minnesota* case announced in no uncertain terms that the supreme court was against duplication in taxation. That was an estate tax case, and some of those present certainly remember the difficulties, and the committee meetings, and the resolutions, in bringing the federal estate tax and the state transfer taxes into some kind of reasonable coordination. We had felt that this lack of duplication in taxation would be extended beyond the realm of estate taxes and perhaps into the realm of property taxes, and other taxes.

Then we have the decisions starting with the *Wheeling Steel* case, in which in connection with the taxation of intangible property, the supreme court looked at the old doctrine of *mobilia sequuntur personam* and said, "This intangible property has now become so real in today's business and so closely associated with the business that is taking place at the business situs here that it can be taxed at the business situs," and we supposed it meant not taxed at the domicile of the corporation in another state.

Then along came the case that Professor Lowndes has referred to this evening, the *First National Bank Stock Co.* case, against Minnesota, this year, in which the supreme court again allowed the taxation of intangible personal property at the business situs of the corporation in Minnesota, although the facts in the case showed that the same bank stocks had already been taxed in North Dakota, Montana, and elsewhere. The supreme court in that case said, through the

mouth of Mr. Justice Stone, that they were specifically not passing on the question as to whether or not it might also be taxed at the domicile of the corporation.

So that I, for one, in connection with the business that I am associated with, would give a good deal to know the answer to that particular confusion or development.

Professor Powell has also mentioned in his paper a similar example, as to whether or not the decision eventually will be that the use tax can be imposed in the state of destination on interstate movements as well as some manufacturing tax or tax of origin in the state of origin.

It is for that reason that business in working out its day to day problem has this feeling of frustration, that it is not being guided by court decisions that can be relied on. The courts are behind. The confusion at the present time in these matters seems to have almost reached its height, and I had begun to wonder as a practical matter just why that was, just what is the situation that seems to bring us up to this point knowing perhaps less about how we can engage in and what the cost of interstate business is going to be than we have ever known before.

Then you have to go back, it seems to me, a little bit into the history of the development of first, the federal taxation for a moment. We found during the war period that the federal taxation augmented its income tax by war profits and excess profits taxes and certain types of excise taxes, also a so-called emergency tax—or that was the excuse for it—on estates, although the estate tax had been deemed to be the prerogative of the states up to that time. Then when the stringency of the war period and the financing following it was over those temporary taxes came off, that is, all except the estate tax, and now again in 1927, 1928, 1929 and on up through the depression period, we have begun to pile tax after tax, as far as federal revenues are concerned, on the picture again. We are now “bang-up” to the point where the complexity of the federal taxes on business has become so pressing, so urgent, so mixed up, so incapable even for the department in Washington itself to anticipate its revenues correctly, that we are getting ready in the session of congress next year for a complete revision.

The only unfortunate part about it is that when we had the last revision ending in the really fine law of 1924, the revenues were adequate and we had no pressing problem of the need of greater revenues and we could drop some taxes and simplify others. Now we are at the top of the cycle of need, and there is only one place for the federal government to go and get the money it really needs, and that is on up. So it is going to be a real job in coordinating any simplification of the federal tax system with the absolute pressing need for revenue that will be faced by the next congress.

The states have had a little bit different historical development.

They started out, as some of your speakers in the last two or three days have told you, on the level of a flat property tax to carry all the load. Then when the load began to increase, as President Leser has referred to that rule of Smoot's law, the government and the states kept spending more and more and there has never been any lapse in that progress, the states began to go up to the next level, a level of income and franchise taxes primarily. That has gone through its period of testing and has become solid in the taxing systems of the various states. Now with the Smoot law needs pressing further and further and the business cycle needs landing just about the right time to help that movement along, the states are still looking for a third and a new type of taxes on another level, not, mind you, to relieve the burden or to reduce the burden of property taxes, but still again pyramided on top of the other taxes that have become customary with the states. So that in both of these historical pictures we stand right now with the pressure of revenue needs both in federal and in state governments practically at its peak for all time, and there doesn't seem any way to jump except on up the line with new and larger taxes.

Of course, in addition to that, whenever states and local governments adopt new types of taxes and you have first this lag in administration. It takes a year and a half to two years for a tax department to really find out what a imperfectly drawn and ambiguous law means. During that period it is perfectly natural for state administrators to resolve everything in favor of the taxing power.

Then there comes the test period in which taxpayers go into the courts to find out whether or not the regulations from an administration point of view are justified under the law. Then, too, there is a temptation as these new sales and use taxes are being adopted by the states to take advantage of that somewhat changed attitude on the part of the court that Professor Powell has pointed out to you, an attitude on the part of the supreme court to sustain state taxation wherever it is possible for them to do it.

All of those things are occurring right now. That is one reason why the courts are behind. That is one practical reason why in the historical development of taxation we are in a state of confusion.

The pressure of revenue is still, as I have said, at its highest point, and as far as I can see, this condition will continue for a long time to come. Expenditures are still increasing, in the federal government particularly. Remember that the United States has three prongs to its ability to meet this situation. The first is, it can tax more now. The second is, it can borrow and tax more later. The third is that by virtue of its being the national government and having control of the currency, it can reduce or soften the value of that currency. The enemies of that process would call that repudiation of debt and those who support it would simply say that is borrowing in advance from the people who will have to pay the bill anyway.

But the states, mind you, don't have the opportunity such as the federal government has. The states have just two things to do. They must tax more now, or they must borrow and tax to pay the debt later on.

You gentlemen, so many of whom are connected with the administrative tax-raising setups of the states of this country, are in this type of a situation that I have described to you. Unquestionably more and more in the next few years you are going to be called in to ways and means committee hearings with the fiscal authorities of your states to suggest how this Smoot law increasing load on your states can be met.

When you do face that, and you are facing that situation now, you are going to find that by virtue of the confusion of the court decisions on interstate commerce you are going to be faced with real competition between yourselves and other taxing authorities.

As between the states we used to have the problem of allocation as the principal one. I remember that when I joined my present company the first problem presented to me was one in which a company operating at that time in ten states, seven of which had income taxes, because of the insistence on the most favorable allocation fraction, was paying an income tax in the aggregate on 163 per cent of its net income measured under the federal standard. But we have worked through to where, primarily by virtue of reasonable laws giving the commissioners of the states more and more discretion in handling unusual and unfair cases we are coming out of the woods on the allocation feature. But in this new pressure for taxes the problem, as I see it, and the competition between the states is the decision of this very confusion, as Professor Powell has described it, as to which state has the right to tax. It is fundamentally a jurisdictional question as between one state or the other, or both states, which must be settled before these new taxes in the fields of sales and use taxes can be ultimately relied on by the states to produce the revenues they need.

We have that same competition right in the localities. Take, for example, the city of New York at the present time. The Union News Company never thought of opening up a paper stand and a cigar counter out in my little suburban commuting station until the sales tax went on in New York City. Then they found out that the six or seven cigars a day man like myself bought his cigars before he went to the city and used the two or three cents saving to purchase his morning paper. They found out that the department stores, especially with respect to suburban buyers, had their expenses of delivery tremendously increased, because even a twenty-five cent purchase was ordered to be sent home rather than delivery taken in the city and the tax imposed on it. The ladies were very quick to find that out.

So that New York City is in real competition with the surrounding territory by virtue of its sales tax.

But the real competition that you administrators will find is the most serious menace to the increasing of the revenue collecting agencies of your state, it seems to me, is the menace that comes out of this confusion from the federal government itself.

The federal government, if it continues to press taxation legislation which in part or primarily has not to do with revenues but has to do with reform and control measures, if it is successful at all in rehabilitating the type of tax turned down in the AAA decision, if it bring agriculture within its control, it must at long last become vocal, and describe agriculture as sufficiently interstate in character that congress can control it.

The same thing is true if the federal government gets to a point where it is politically possible to adopt a general sales tax in the form of a manufacturers' excise tax at source—I mean in addition to the fifty-three or fifty-four products already covered by the special excises. It is going to conveniently use the door of interstate commerce to make that taxation and that regulation possible.

It seems to me that the pressure of needed revenues for the United States government, in this increasing expenditures Smoot law progress that it is making, is very apt to force congress to become not silently vocal but vocally vocal on the question of its power and not the states' power to regulate interstate commerce, dealings in interstate commerce, and business in interstate commerce by taxation. That is the competition that the states in this country need fear.

Just to digress a moment, and I am not a calamity howler at all, I am just trying to make it perfectly plain that business is quite conscious of the fact that the pressure of revenue needs on taxing administrators is going to continue for a long time in the future. If we are successful in balancing the federal budget in the next year or two, it is significant to note that it will be balanced at the top of a business cycle, at the time when the most revenue could be expected from existing tax laws.

Why, gentlemen, if a factory could only show that it could bear its expenses by operating at 100 per cent twenty-four hours a day, the SEC wouldn't let it sell any stock to the public. But that is exactly the condition the country is in now.

These historical cycles of high-pressure taxes are very clear to me because I come in contact with some of the other countries that are much further down the road of tax needs than the United States itself. I wish I had time to go on and give you the cycle of increasing taxes in the fascist country of Italy, for instance. It had gone through all of the increase in rate stage, the addition of new taxes stage, until it had reached a point of diminishing returns,

and only about three weeks ago the first capital levy of ten per cent was made on business, with, mind you, a real Tugwellian touch in that the tax could be paid by the issuance of new stock in that corporation to the government, making the government a stockholder in the business.

I have also read in connection with that that it is ironic that the history of taxation in Italy shows that Italy at the present time is going through the same physical processes that were invoked almost to a "t" during the decline and fall of the first Roman Empire many centuries ago.

But we haven't got to that point yet. I am simply emphasizing this, that there will be this pressure on you people in the state and you people in the federal government to get more taxes and to seek more sources of taxation, and we sources of taxation readily appreciate that.

Well, so much for that general picture. I am going to say just a word on how business actually looks at this rather dark picture, and I think I can be perfectly frank because it seems to me to be humanly obvious. Like begets like. It is human for people to come back and respond to the same type of treatment that they get. If I address you in the most facetious manner you will smile with me and go along with me on the frothy side of the subject.

It is reasonably obvious to me that the state tax administrators in the next few years, forced by this measure, are going to forget about Queensberry rules, one arm free, and go into this matter and after the business sources of taxation with both arms. I don't believe that the catch-as-catch-can approach that will be necessitated by taxing authorities will meet with any different approach on the part of business.

It is extremely difficult for business men and boards of directors to understand these fine legal distinctions. If I had just a little more time I would like to tell you how I go into as fine and well-trained a business board as I think exists in this country, men who have come up through long years of experience, and I say to them, "We have a lot more taxes in state X down here."

They say, "Why?"

I say, "Well, we have a bulk tank located about five miles over the line in X at 'Squeedunk Corners.'"

They say, "Good heavens, man, we put that tank over there for the convenience of county road commissioners and the county school buses."

"Well," say I, "you sell something to outsiders over there."

"Do you mean that that puts us in business in that state?"

I say, "Yes."

"Well, after all, we don't do very much business over there. The tax can't be high."

"Well," I say, "once you are in with a little business—" then I start in on the explanation of allocation of fractions to the total income and the total capital invested elsewhere and so forth and so forth.

Pretty soon they say, "Well, hell, take the tank out and put it on a flat car and take it over into Y where it belongs and we won't be convenient for these fellows any more, or run a three-inch pipeline up there and make it truly interstate commerce and we can deliver all we can right now."

That is the practical comeback to these fine distinctions of the law that we are facing. There is a real reason why business will approach this new era of increased taxation on a strict catch-as-catch-can basis, and the reason is that the tax cost, as shown by the annual report of my companies for 1936, for the first time in our history exceeded labor costs.

Our budget looks something like this. Raw materials for manufacture first, taxation second, labor third, and the cost of actual manufacturing, by virtue of improvements, has dropped way down the line to fifth, sixth or seventh. So it is important, this burden of taxation to business.

Now just a final word on the difficulties that we are facing. I think the best way I can describe that is that here is an athlete who goes to college and he is one of the best forward pass catchers, so they need him on the football team. He is one of the few men in college who can get a basket ball through the hoop from beyond the middle of the court and they need a good forward that year. He is the best backstroke man they have and they are weak on the swimming team in that respect. Consequently, they put him out for all these activities and pretty soon he finds that he hasn't much time for class-room or home-work.

Business finds itself today, by virtue of the confusion and rapid changes in taxation particularly, and other control features of federal and state legislation, to be in pretty much the same condition. Our non-curricula activities that don't bring a nickel into the till keep us so busy that we haven't much time for our legitimate home-work, and with the business cycle as it is, business ought to be paying a lot of attention to its home-work these days.

We have a perfectly good manual of accounting that has been worked out in connection with the best of certified public accounting firms. We do it in order to know that all of our companies are working on the same basis, and yet there isn't a single report that is required that sticks anywhere near to the figures shown in that perfect manual of accounting for our industry. The SEC says, "No, you have to take something out of your item seventeen and put it over into twenty-one on our form, and some of these reserves that you regard as good reserves are nothing but contingent reserves. Throw those back into the undistributed and free surplus."

Then we say, "All right," and then we come to the federal income tax return.

They say, "No, your books are all wrong on that, because you have taken much too much depreciation, regardless of how reasonable you think it is."

We say, "All right," and we make out another type of balance sheet and profit and loss statement for that return. Then we come up to the first state and we say, "How about taking our federal return?"

They say, "No, our rules are different from that."

So we make another for them, but that doesn't fit the state next door, which thinks it has progressed much farther than the other state with the income tax return.

Along come the social security people and say, "You don't keep your payrolls the way our returns are made out."

So our non-curricula activities are keeping us away from our home-work. I suppose it is futile in the confusion and pressure that will face the taxing authorities ahead to expect that we can have simplified tax laws, that we can have tax laws that will give us an opportunity to do some business on the side in addition to making out forms, that will give us an opportunity to know ahead of time and reasonably anticipate what our tax costs might be. I suppose I am looking right square into Utopia.

Professor Powell has depicted in his own inimitable way the legal confusion of the taxing status of interstate commerce at the present time. In my wandering I have tried to add to the confusion in prognosticating some of the practical difficulties that I see ahead for both the administrator and for the taxpayer, and without either of us having mentioned or suggested in the slightest way any solution, we lay this wailing little problem right back on your lap and doorstep for discussion.

CHAIRMAN TOBIN: Thank you, Mr. McDowell. We surely appreciate your talk and feel that it is a very excellent complement to Professor Powell's paper.

The meeting is now open for general discussion. We do hope with all this fine talk and well-worded open meeting that we will have something more at this time. I noticed as we moved along that Professor Powell took down some notes, against some of his students. Possibly he would like to have something to say in connection with those notes.

MR. POWELL: I did wish that Mr. McDowell had said how nice this all was for the tax lawyers—all that bother.

CHAIRMAN TOBIN: There is plenty of time. There is nothing else to do except go to bed after this session is over, so we would like to keep it going, if you wish. If there is anyone present who

wants to discuss that which has been said through the session, we will be very glad to hear from you at this time.

I hope you are not all stilled by the fineness of the papers that have preceded this time. We would be glad to hear from anybody at this time on these important court interpretations and decisions.

The secretary has some notices to read.

SECRETARY W. G. QUERY: In calling the list of the appointments a few minutes ago, I overlooked calling the delegate from Indiana. Mr. Zoercher has called my attention to the fact that Mr. Marshall Williams has been delegated by the Indiana group as a member of the resolutions committee. If Mr. Marshall Williams is in the room we would like him to meet with Mr. Maxwell and the other gentlemen whose names were called.

PHILIP ZOERCHER (Indiana): Ask whether he is here. If he isn't, I want the Senator to be on the committee.

SECRETARY W. G. QUERY: Is Mr. Marshall Williams in the room? He doesn't answer. Whom do you want in his place?

MR. ZOERCHER: Senator Ketchum.

SECRETARY W. G. QUERY: Senator Ketchum, then, has been requested to serve instead of Mr. Williams.

Mr. Holcomb wants me to announce a meeting of the nominations committee composed of Mr. Lutz, Mr. Fairchild, Mr. Haig, Mr. Zoercher, Mr. Long, Mr. Edmonds and Mr. Holcomb and the three appointed members, Mr. Knapp, Mr. Lamb and Mr. Brown, in this room immediately after adjournment of this session.

CHAIRMAN TOBIN: Is there any further business for this session? If not I will be pleased to entertain a motion to adjourn.

PRESIDENT LESER: I move we adjourn.

(The motion was duly seconded)

CHAIRMAN TOBIN: All those in favor of adjournment will please signify by saying, aye.

(Ayes)

CHAIRMAN TOBIN: Opposed, no.

(None)

CHAIRMAN TOBIN: The meeting is adjourned.

TENTH SESSION

THURSDAY, OCTOBER 28, 1937, 9:30 A. M.

CHARLES W. GERSTENBERG, New York City, presiding officer.

CHAIRMAN GERSTENBERG: Good morning, Ladies and Gentlemen. Will you please give your attention first to Mr. Query, who has an announcement to make?

SECRETARY W. G. QUERY: If you will notice your program, the eleventh session of this conference is a luncheon session at 12:30. This luncheon will be served in the parlor just to my left and tickets will be on sale in a few minutes at my desk. The hotel management is anxious to know in advance how many covers they will have to lay so I would like for you to secure your tickets as early as possible.

CHAIRMAN GERSTENBERG: If I may be permitted to say a word or two before I introduce the speakers, perhaps some more people will come into the room. We have three interesting talks this morning. The first one is on a subject that has many implications beyond those that seem apparent on the face of it. The title is, "Amalgamated Federal-State Tax Administration in Australia." I presume that you all feel as I do, that as we move from individualism toward collectivism, one of the important battlegrounds where resistance is being most effectively given is in that field of the division of powers between the federal and the state governments. We need only go to the most important cases of recent years, such as the chicken case, the Schechter case, to realize that important political and social doctrines are settled by the supreme court on the basis of that principle of the separation of powers of the state and federal governments.

I remember in 1924 going to the London Bar Association meeting with Judge Leser and a number of others. I was sitting on the deck beside Dean Pound. Naturally many of the lawyers from various states who had been his students gathered around and discussed questions of law. I was rather interested that thirteen years ago the one question that came up on several mornings was the relation of state to federal government. The question seemed very elementary at that time and certainly did not have the significance that it has now.

Nobody has recognized the importance of that question more than Professor Haig. He has thought it so important that he has gone

around the world to get what light he could from another republic. The federal government of Australia and the provinces have worked out their problems, and he wanted to find out what they had accomplished. He came back late this spring and is now going to talk to us on this subject, "Amalgamated Federal-State Tax Administration in Australia."

I think you will all be interested in keeping in mind while he is talking the problems of the American government.

I have great pleasure in introducing to you the professor of economics at Columbia, the president of this association in 1932, Dr. Haig.

AMALGAMATED FEDERAL-STATE TAX ADMINISTRATION IN AUSTRALIA

ROBERT MURRAY HAIG

McVickar Professor of Political Economy,
Columbia University

I bring to you this morning a brief account of the manner in which Australia, a country in many respects very similar to our own, has attacked with a high measure of success the problem presented by the duplication of tax machinery in a federal state. It is particularly fitting that this account should be given before this gathering, composed, as it is, so largely of state tax administrators, for in Australia much of the credit for the successful amalgamation of federal and state administrations belongs to the tax officials of the Australian states.

We are all aware of the pitfalls that lurk in the path of one who attempts to apply the experiences of another land to the current problems of his own country. Conditions are never identical, and seldom indeed are they so similar that one can transplant any fiscal flower with complete confidence that it will flourish in its new environment. However, if one uses care in his analysis of similarities and differences, he can hope to find much that is suggestive in the experiences of others. I believe that suggestions valuable to us are to be found in the history of federal-state tax administration in Australia.

Picture, if you will, a country almost exactly the size and shape of the continental United States but with only six, instead of forty-eight states and with only seven million instead of one hundred and thirty millions of people but whose small population is remarkably homogeneous, being almost completely of British extraction; a country whose vast empty interior holds relatively slight possibilities of development and whose population is heavily concentrated in a green belt along the south and west coasts, very largely in two great cities; a country with a substantial and growing industrial development; a new country whose active settlement dates only from

the time of our Revolution and which until 1900 existed as a collection of independent jurisdictions somewhat like our original colonies, with tariff barriers erected against each other and with a flourishing crop of local prides and jealousies; a country whose political and legal structure stems largely from British precedents and whose departures from those precedents resemble our own; a country which, when it decided to unite into a federation of states, paid us the sincere compliment of imitation and adopted substantially the Constitution of the United States as the Constitution of the Commonwealth of Australia; a country in which the tradition of the states' rights remains strong and where as late as 1933 one state made the futile gesture of formally voting to secede from the federal union; a country where even today a visitor hears expressions of opinion which strongly suggest the situation in South Carolina a hundred years ago; a country in which interstate jealousies are so strong that it has thus far proved impossible to adopt a uniform gauge among the state-owned railways; a country where, in both the federal and state spheres, they have preferred to use the British pattern of a responsible ministry rather than to separate sharply the executive and legislative functions; a country which has been heavily influenced by British practice and traditions in the field of civil service and which has little sympathy with Andrew Jackson's dictum that "the duties of any public office are so simple or admit of being made so simple that any man can in a short time become master of them"; a country which, in formulating its federal and state tax system, has chosen to stress a relatively small number of important taxes rather than to multiply the number of minor and insignificant ones, with the result that their tax system has at least the appearance of being structurally more simple; a country whose taxation history closely parallels our own, in which tariffs and excises, for example, are the traditional sources of federal revenue but where under the stress of increased requirements, particularly those traceable to the war, the federal government has invaded the traditional tax resources of the states, duplicating existing state levies on individual and corporate income, on estates and on land, as well as certain minor indirect taxes; a country in which the constitutional powers of the federal government with reference to taxation practically duplicate our own except for our limitation upon federal direct taxes; a country where in their capacities and limitations, in their attitudes and reactions, the tax-layers, the tax-gatherers and the tax-payers are human beings more nearly like ourselves than is true of perhaps any other country in the world.

In Australia in the year 1915, an income tax was already in operation in each one of the six states when, suddenly, the central government found it desirable to superimpose a federal income tax. Thus, overnight, practically every income taxpayer in Australia

found himself facing two income tax laws and two sets of income tax officials. I am inclined to believe that, if in the year 1913 every American state had been imposing income taxes, the establishment of our new federal income tax would have provoked a reaction very similar to that which developed in Australia. There the duplication in the administration of the same type of tax by two jurisdictions outraged the taxpayers' conception of reason. In the mind of the Australian it simply did not make sense to fill out two income tax forms and to deal with two sets of income tax auditors. Immediately an agitation began for the elimination of duplication in administration, an agitation which within a few years resulted in the present pattern of amalgamated tax administration. In our country duplication in the income tax has crept in, almost stealthily, by a process of gradual accretion, rather than with dramatic suddenness; we have done nothing but talk about it, while Australia has acted.

It is of particular interest to study the existing pattern of amalgamated tax administration in Australia because the amalgamation is of two distinct types. In one state (Western Australia) an arrangement was made in 1920 under which the state hired the federal government to administer practically its entire state revenue system. In the remaining five states the state authorities could not be persuaded to enter into any such arrangement, and in these states the federal government, after prolonged negotiations, finally agreed in 1923 to farm out to the states the administration of the greater part of the federal income taxes on both individuals and corporations. Consequently for a period of 17 years there has been proceeding in one state an experiment with the administration of a whole range of state taxes by the federal government, while for 14 years in five states there has been under way an experiment with the state administration of one important federal tax. The Australian evidence regarding the operation of amalgamation arrangements is further enriched by the fact that certain of the eastern states, which had insisted on state rather than federal administration in the case of income taxes, nevertheless solicited the services of the federal government in connection with the administration of their entertainment or admission taxes. Before proceeding with an account of Australian experience under this rather complicated pattern of amalgamated administration, it is desirable to describe in somewhat greater detail the evolution and the character of the administrative arrangements briefly outlined above.

From the very beginning it was recognized in Australia that mere amalgamation of administration with no uniformity in the income tax provisions would yield only relatively meager economies and the efforts to achieve amalgamation became intertwined with efforts to secure uniformity. In 1915, when the new federal income tax statute was being drafted, there was an offer from the states to

administer the new federal law and there was a suggestion that its form be made to coincide with that of either the Victoria or the New South Wales act in order that there might be uniformity in at least one large state and that there might be pressure upon the other states to conform to the federal statute. A sincere effort appears to have been made to draft the new federal law so as to harmonize as closely as possible with the existing state laws, but the necessary or desirable variations proved to be numerous. A conference of premiers in December, 1916, decided that the state tax officials should be called upon to prepare a uniform scheme for the income tax, and in 1917 these officers presented a report containing a draft of a proposed uniform law but which did not discuss the question as to whether the federal or the state government should administer the proposed act. In May of 1918, the federal treasurer, Mr. Watt, startled the country when, in a speech in the parliament, he stated that the federal government could afford to collect the taxes of any state at one-half the current cost to the state. A few months later, in January, 1919, Mr. Watt made a definite and firm offer to take over the administration of any state tax system for one-third of the amount which it was then costing the state to collect its taxes. Again in July, 1920, Prime Minister Hughes, referred to the Watt offer of the previous year, and stated that the proposition was still open. This bargain offered by the federal ministers attracted only one state, Western Australia, with which a formal agreement was drawn up in December, 1920. During the years that followed strong efforts continued to be made to persuade the five eastern states to enter into similar arrangements, but without success. In the course of the discussion the situation became complicated with various proposals for the segregation of sources of revenue between the federal and state governments. At one stage a proposal that the federal government resign the personal income tax entirely to the states, retaining the corporate income tax alone, was seriously considered. At another stage it was suggested that the states be given small incomes for taxation and the federal government retain the large incomes, but all such segregation proposals proved, upon analysis, to be unsatisfactory. The demand from the taxpayers for the relief of the burden with duplicate administration finally became so strong as to force action of some character, and in the closing months of 1923 the federal authorities capitulated and entered into agreements with the five states along the following lines.

The administration of the federal income tax within the limits of each of the five states was entrusted to the state tax commissioner of that state, who receives an additional appointment as deputy federal tax commissioner. The state was compensated for its services essentially on a cost basis. Taxpayers, both personal and corporate, whose interests extended beyond state lines were to continue to be

assessed as before. The practical effect of this arrangement is that in the year 1935, for example, 96.5 per cent of all individuals paying federal personal income tax were able to discharge their liabilities to both the federal and state governments on the basis of a single return, and similarly that 86.4 per cent of all corporations paying the federal income tax found it necessary to file but one return. The fact remains, of course, that the existing pattern of amalgamated tax administration in Australia, dominated as it is by state administration of federal, rather than federal administration of state taxes, offers on its face at least little relief to the individual or the corporation whose economic interests are widespread. In the case of the individual, the simple rule, recommended by the committee on a model plan of this association, that all personal income shall be taxable in the state of residence of the taxpayer, does not apply. Consequently, it is conceivable that an individual taxpayer in Australia whose assets are distributed in a particular fashion, or a corporation in Australia which does business on a nation-wide scale, may be compelled to file separate income tax returns with the federal authorities and with the authorities of each of six individual states. The actual relief in such cases is, however, much more substantial than would appear at first glance. This is due to two circumstances. The first is the great progress that has been made in recent years in the movement to secure uniformity in the income tax statutes of the various jurisdictions, a movement that has been greatly facilitated by the existence of amalgamated administration. Due largely to the admirable efforts of Sir David Ferguson and Mr. Edwin V. Nixon, who constituted the two-man Royal Commission on Taxation, appointed in 1932, a so-called uniform income tax statute has been passed by the federal parliament and by all of the states except one and the concurrence of this state is imminent. This statute achieves substantial but not complete uniformity. There remain variations from state to state on such points as special concessions to favored industries, special treatment of capital gains and losses, so-called concessional deductions, such as personal exemptions. Complete freedom is retained by all of the states to impose any rates they choose and to amend their law from time to time as they may desire. Substantial uniformity has also been achieved in the division of taxable income of corporations among the states. The only exception is that one state (Queensland) has thus far failed to accept the weighting of $33\frac{1}{3}$ per cent which is assigned to the element of sales in the distribution formula, and still insists upon a weighting of 50 per cent, but it is rumored that this final irregularity is about to be eliminated.

The second circumstance that has tended to ameliorate the situation for the taxpayer with income arising in more than one state has been the development of a high degree of informal cooperation

among the tax commissioners of the individual states. The situation may be illustrated by the solution that has been worked out in connection with the assessment of banks. Banking in Australia is conducted by a number of large banks with many branches. It happens that all but four of the banks of Australia have their head offices located in Melbourne, in the state of Victoria. In 1935 the tax commissioner of Victoria, at a conference of the state tax commissioners at Canberra, volunteered to examine the accounts of the banks having head offices in Victoria, to allocate the profits among the several states and to send to each state tax commissioner a suggested assessment for each state. The commissioners of the other states agreed to undertake a similar assessment for the four banks whose head offices were located in their jurisdictions. The result is that, without any formal legal action, the Victoria State Tax Commissioner now assesses the income of virtually all of the banks for all of the states in Australia, to the enormous relief of everyone concerned. Similarly, a practice has developed under which the tax commissioner of the state in which an interstate corporation has its head office undertakes to transmit to the tax commissioners of every other state in which the corporation does business the details of the assessment of the corporation in his state, including a report as to the percentage of the total income which the corporation claims was earned in each state.

There can be no question but that these efforts to solve by co-operation among state tax officials the problem of assessing the net income of individuals and corporations deriving income from more than one state is somewhat awkward and cumbersome compared with the theoretical possibilities of assessment by a single federal authority, but assessment by the central assessment authority proved to be unacceptable in Australia, and it must be conceded that the state officials have achieved substantial and remarkable results within the limitations of the existing pattern of the amalgamated tax administration.

It is not possible in brief compass to describe the achievements and failures of amalgamated administration in Australia. In general the verdict is clear. The experiments have justified themselves and any proposal to revert to the administrative duplication that previously obtained would receive no consideration whatsoever.

As to the economies actually achieved for the federal and state treasuries, it would be impossible, even with an exhaustive accounting analysis, to secure a satisfactory estimate. Various statements have, indeed, been made by ministers who played a part in bringing about the amalgamations. Thus Mr. Page, in 1926, claimed that the new plan had brought an annual saving to the federal treasury of about £200,000 and had rendered unnecessary the services of 600 officials. But all such statements are discounted by those in a posi-

tion to know all the surrounding circumstances, and any estimate is hazardous because of disturbing factors. For example, the introduction of the scheme was accompanied by a change in the initial personal exemption under the federal tax, a change which reduced by approximately one-half the number of federal taxpayers. Moreover, higher standards of administration were introduced in several of the states so that the product was really not the same before and after amalgamation. Finally the significance of any estimate of saving as a guide to what might be expected elsewhere was largely destroyed by the adoption of a policy of extreme leniency in caring for superfluous employees. In Western Australia, it will be recalled, the original bargain, which held for a five-year period, called for a reduction of costs to the state of two-thirds. It is now frankly admitted that this fraction bore no relationship whatsoever to any careful estimate of the actual savings in prospect and that its size was strongly affected by other considerations. The presumption that it was grossly excessive as an estimate of the real saving is supported by the fact that when the agreement came up for renewal, the federal government secured a substantial revision upward on the ground that the actual costs to it were substantially in excess of the figure agreed to at the time of the original bargain. Some hard feeling, for which there appears to be some justification, arose from this episode. But even at the higher figures now in effect, the Western Australian officials acknowledge that, considering the quality of administration supplied, they have a fine bargain.

As to the very substantial character of the saving to the taxpayer there is no doubt whatsoever. So generally are the advantages of the existing arrangement recognized that any arrangement involving duplication of forms and audits now seems to the Australian to be intolerable and discussion is reduced largely to squabbles between politicians, officials and taxpayers' associations regarding the share of the credit they deserve for having brought about the adoption of the amalgamation plan.

The general verdict of approval does not mean that the amalgamation was introduced without any friction whatsoever or that it has worked perfectly without skillful adjustments and tactful management. But the difficulties encountered have been surprisingly few and insignificant. Abstractly one would expect serious friction when a single official is vested simultaneously with authority as both a state and a federal officer. There have been episodes arising from this rather anomalous situation but they have not been serious. For example, in Western Australia there have been occasions when it was felt that it was unfortunate from the point of view of the interests of the state that the commissioner of taxation was primarily a federal official who would feel embarrassed in taking a position as an advocate of the state in controversy with the federal

authorities. Upon one occasion, in New South Wales, a state commissioner of taxation who was also a federal deputy commissioner indulged in certain ill-advised comments on the character of his federal colleagues to the irritation of all concerned. There have been instances where a state commissioner, who was also a federal deputy, initiated investigations outside the limits of his own state that seemed to serve only state and not federal objectives and which caused resentment from taxpayers. But in general the commissioners have been remarkably successful in playing the role of Poo-Bah. Again, the actual merging of the state and federal staffs upon amalgamation was accomplished with little trouble although in one state (South Australia) the state staff was sufficiently aroused by alleged discriminations to prepare a round-robin protest but this difficulty was soon satisfactorily adjusted. Originally certain high federal officials were bitterly opposed to state administration of the federal income tax but once the decision was taken they cooperated loyally and tactfully to promote the success of the new arrangement. It has been strongly intimated that this exercise of tact by the federal authorities had been in some instances so generous as to tolerate some variation in the strictness with which the federal law is administered in the various states. Certainly the federal officials feel that a stronger central control, based upon stricter inspection and supervision of the assessment procedure, is highly desirable. They also feel that there should be more formal arrangements for insuring that appointees to the position of state tax commissioner shall be fully acceptable to the federal office, but they profess to find little ground for complaint in the manner in which the existing informal arrangement has operated thus far. The physical mingling of federal and state records presents a problem in case of a desire to withdraw from the amalgamation arrangement. This point became a dramatic issue in connection with the Lang episode in New South Wales in 1932, when in the course of a dispute with the federal authorities that brought Australia to the verge of civil war, Premier Lang seized the tax records, in which his government had an undivided interest, with the object of preventing the issuance of federal tax bills. But this was a mere bit of incidental by-play in connection with a struggle of wide ramifications. Mr. Lang is today a strong supporter of amalgamated administration. It is interesting that the only man of high standing in Australia who expressed himself as in favor of abandoning the existing amalgamation arrangements and reverting to the old duplication was one of Mr. Lang's successful opponents on the federal side during this episode. To him, after the struggle, no price seemed too high to pay for complete segregation of federal and state records. Certainly difficulties have not arisen in the volume that one might anticipate.

In spite of some obvious structural defects, the Australians have made their scheme work.

What is the significance of the Australian experience for us? Summarized in a single sentence it appears to be this: that in a federation of states very similar to our own it is possible to eliminate most of the wastes of duplicated tax machinery without impairing the freedom of either the central government or of the individual state to control everything of importance in connection with its revenue system. More specifically they have demonstrated that in a situation where federal administration of state income taxes is for any reason unacceptable, the state administration of federal taxes may be a reform well worth striving for. Australia has demonstrated that her states can be permitted any degree of variation in rates, exemptions or definition of the tax base they desire and can even be permitted to run the whole administrative show, if they insist, and the results of amalgamation will still be well worth the effort. It should be noted, however, that informed opinion in Australia is convinced that the possibilities of achieving a satisfactory solution of the problem of duplication in administration are greater with federal than with state administration of any amalgamated system and many of those who were loudest in their advocacy of state as opposed to federal administration now privately admit that the capitulation of the federal authorities in 1923, although perhaps necessary, was unfortunate.

During the course of my conferences in Australia, whenever I encountered a thoughtful man who was familiar with the detailed working of their experiment, I made it a point to describe our own conditions in this country in some detail and to seek from him an expression of judgment regarding the amalgamation pattern best adapted to our situation. To my surprise most of them preferred neither the federal administration of state taxes nor the state administration of federal taxes. Instead there was substantial agreement among Australian students of the problem that under our conditions the most promising type of amalgamation was that of a small joint federal-state board or authority to be established for the specific purpose of administering the federal income tax and of the income taxes of such states as might care to take advantage of its services. They pointed out that on such a board, representation would presumably be divided on some mutually satisfactory basis between the federal government and the cooperating states. Such a board, they thought, should build up a permanent civil service of its own, on the highest possible plane, recruited to such extent as seems desirable from present federal and state income tax officials. In their opinion it would be possible to initiate such an arrangement if only one or two important states desired to cooperate, but once inaugurated, even on a modest scale, the advantages to both the

governmental bodies and to the taxpayers would, in their opinion, be so great that public sentiment would gradually bring about general cooperation by all the states imposing income taxes.

This survey of amalgamated federal-state tax administration in Australia suggests then that, under several different types or patterns of amalgamation, we may reasonably anticipate highly desirable results, such as at least modest direct economies in administrative costs to the public treasuries, large savings to taxpayers through reductions in the costs of compliance, a more reasonable degree of uniformity in the language and substance of the income tax statutes and less of both evasion and unjust double taxation of income. Some of our difficulties, it is true, are greater than those in Australia, because of factors such as our larger number of states, the relative lack of facilities, under our scheme of separation of powers, for responsible interstate and state-federal conference and planning, and our less permanent and less well-trained administrative personnel. But it is also true that the rewards which would accrue from a satisfactory solution of this problem are much greater here than in Australia. These prospective rewards should serve to stimulate us to attack our problem with the wit and will displayed by our cousins in the Antipodes.

CHAIRMAN GERSTENBERG: We are grateful to Dr. Haig for his paper.

We are now to have a paper on "The Effects of a Federal Tax Program that will be Adequate for Debt Retirement." I presume we all feel that the debt of the United States has assumed astronomical figures. I verified a moment ago as I was sitting beside Dr. Magill the fact that our debt now is almost \$37,000,000,000, and having had a preview in the spring of Dr. Haig's speech, at one of Mr. Edmonds' inimitable luncheons, I took the time to divide \$37,000,000,000 by 125,000,000 and I found that each person in this room owes \$300. Now, what is going to happen when this curse of our poverty is redeemed?

We are very fortunate in having that subject attacked by a person who has also given attention to what has happened in other countries. Dr. Comstock is known to all of us. She is a professor at Mount Holyoke College, one of the editors of the *American Economic Review*, published by the American Economic Association.

I take great pleasure in presenting to you a rose between two orchids, Miss Comstock.

THE EFFECTS OF A FEDERAL TAX PROGRAM THAT WILL BE ADEQUATE FOR SUBSTANTIAL DEBT REDUCTION

ALZADA COMSTOCK
Mount Holyoke College

I have accepted an impossible assignment. Although I was free, white and twenty-one and presumably of sound mind, some time last spring I agreed, voluntarily and without being subjected to pressure of any kind except the force of suggestion, to address this meeting on the subject, "The Effects of a Federal Tax Program that will be Adequate for Substantial Debt Reduction." I have therefore no one but myself to blame for the fact that I am about to do some things that I strongly disapprove of doing and some other things which cannot be done except by a master logician who has at the same time a superhuman omniscience.

I disapprove of economists who are too free with their so-called information about what is going to happen to the country five years from now and ten years from now, and I take no stock in their prophecies themselves. Our profession, which is still a stimulating and pleasant one to pursue, has nevertheless none too good a reputation with the man in the street at the present time. For this unpopularity the economists' inability to resist the temptation to tell fortunes is partly responsible. Brain-trusters and other professional optimists—I name no names—early were sent into outer darkness by the ordinary citizen; in part because they dared to mix at all in national affairs—for our American demands that its academic economists, like its professors of Latin and Greek, limit their activities to promenading under campus elms and forgetting their umbrellas—but also in part because they foretold the future and foretold it wrong.

To accompany these gentlemen in outer darkness subsequently went our professional economic pessimists—again I name no names—who awaited hourly the downfall of the state, the constitution, the home, the church, and all that every respectable American holds dear; for they, too, foretold the future and foretold it wrong. Preceding them all, in 1929, went nearly all of our professional forecasters of business conditions. In outer darkness these last still remain, except for those brief moments when the stock market is rising, when we are glad to hear from them again.

All I can say is: the economists asked for it. And they got what they asked for. And now I, too, because of that one brief moment of unwisdom last spring, must join the ranks of those comical men who looked into the crystal ball and prophesied that a tall, large man with eye-glasses would change our national life and that it was dangerous to cross water.

In the next place, this subject, "The Effects of a Federal Tax Program that will be Adequate for Substantial Debt Retirement," presupposes, not only the gift of clairvoyance, but also super-human logic.

First, I must assume that the national deficit can soon be wiped out and the budget balanced, and I must specify the level at which the budget can be balanced, whether it is six billions or seven or eight or nine. For if I do not know how heavy taxation is to be I cannot prophesy the effects of the taxes to be used.

Second, I must imagine, and with plausibility, the level of national taxation which will, in the long run, permit of substantial debt retirement. For unless I can tell you that level I cannot, once again, specify the effects of the taxation involved.

Third, I must guess reasonably well at the amount of annual federal debt retirement which this audience, largely composed of specialists, will agree to be "substantial" debt retirement. Otherwise I shall have no agreement for my subsequent arguments.

Fourth, I must be able to foretell the kind of taxes that congress in its wisdom is going to elect to use, or I shall of course have wasted my time and yours completely by dwelling on something that will never have happened after all.

Fifth, I must be able to foresee and to analyze vividly for you the effect of each and every one of those taxes upon the farmer, the wage-earner, the employer, the national income, the standard of living, personal initiative, and the international position of the United States.

Sixth and last, I must of course be able to foretell with accuracy the course of the business cycle for the next ten or fifteen years if any part of my fortune-telling is to have any validity at all.

If I can do all this I shall be worth my weight in gold to Wall Street when this talk is over. Even in the devalued dollar, I shall be a pearl without price.

What I should do and where I should be in this emergency without the reports of the Twentieth Century Fund I can scarcely imagine. Thanks to two of the recent publications of that organization, *The National Debt and Government Credit* (rather boldly sub-titled "A Program of Action") and the earlier volume, *Facing the Tax Problem*, I am not unprovided with a picture of the future painted by better men than myself. Flanked as I am on this program, where I follow one member of the Twentieth Century Fund's Committee on Taxation and precede another member, I cannot but feel that it would be fitting if one of these gentlemen, rather than I, were grappling with these problems.

In the volume *The National Debt and Government Credit* the Twentieth Century Fund's Committee on Government Credit has tackled three of the six difficulties which beset this subject. The

first is, when the budget can be and should be balanced. The committee believes that nothing except dire emergency should be allowed to interfere with the actual balancing of the budget in the fiscal year 1938. The committee had, however (or so I gather), only the budget estimates of last January with which to contend. Since that time, as you know, the deficit for 1938 has once been placed at \$418 million, and now, in October, at almost \$700,000,000. The committee members realized, however, that taxes might fall short of the estimates—as indeed they have—and added that in that case “additional revenues consistent with a sound public policy” should be provided in the 1937 regular session of congress.

At this point there enters another of our seers, Mr. David Lawrence, who asks, in last Monday's *United States News*, “Can the business and industry of the country be taxed sufficiently to support a \$7,000,000,000 budget?” And answers his own question: “I doubt it unless inflation is resumed and the national income is expanded, a temporary and unwise expedient.”

So even at this point the doctors disagree, and I have not even a balanced budget to work on. If I had not realized earlier that balancing the budget is no easy task, I should have been convinced by seeing “I'd Rather be Right” and its reproduction of the difficulties of the president, in the person of Mr. George M. Cohan, in thinking up additional revenues. Those of you who have seen this not wholly fantastic fantasy will remember that after the program of getting the women to turn over to the government their cosmetic money, in short to “give up beauty,” has failed, the president tried to use some of the gold buried in the vaults at Fort Knox. But no gold was ever moved. Wall Street flickers and crashes as the first door opens and the order is countermanded. The president, almost desperate, turns to the possibility of selling some of the great properties which the federal government has acquired since he came into office. “Do we,” he asks, “after all, need Baltimore?”

The Twentieth Century Fund's Committee on Government Credit has now some suggestions for my second difficulty, although we must leave the first temporarily unsolved. When should substantial debt reduction begin? The committee answers: “unless a serious set-back in business activity occurs, substantial debt reduction should begin in the fiscal year 1939.” (*The National Debt and Government Credit*, page 154.) But *has* a “serious set-back in business activity occurred?” How serious are falling steel orders and all the other factors that seem to have given Wall Street the jitters not so long back? And what of those increasing deficits reported in this calendar year 1937?

But let us take what comfort we can. The committee offers a good workable definition of “substantial.” The members remark that the president's tentatively estimated surplus of \$400 million is

inadequate for a program of desirable debt reduction and strongly advocate, instead, debt retirement of at least one billion in 1939. I take it that we, the committee and I, may be granted your agreement on that. And history is with us. A billion a year was the rate at which the national debt was reduced from its high of \$26 billion in 1920 to its post-war low of \$16 billion in 1930, to the great satisfaction of all concerned.

And that is all the satisfaction we may have at the moment. For last week's estimate of a current deficit of \$700 million is now with us, and where are those "additional revenues" advocated by the committee? Apparently we are not going to have them, at least just yet. The balancing of the budget in 1938, the beginning of substantial debt reduction in 1939, all rest now on the prompt raising of those "additional revenues." All I have left in the world at this point is a definition of "substantial" debt retirement.

From now on the rest is speculation as to what might happen to our revenue in the best of all possible worlds at some future time, even if that time is not the fiscal year 1939. Once again the Twentieth Century Fund comes to our rescue, this time with its committee on taxation and the volume *Facing the Tax Problem*. After as careful work on the figures as we could humanly expect from any organization, the research staff which prepared the greater part of this volume comes to the conclusion that the existing federal taxes could be made to yield several billion dollars more than they now do, at least in a period of great prosperity.

The argument runs like this: if recovery continues, and we get back to the Utopia of the peak year of incomes, 1928, even our present personal income tax rates would yield almost \$3 billion, or substantially more than twice as much as the tax has ever yielded. (*Facing the Tax Problem*, p. 71.) If the personal exemptions were lowered from the present \$2,500 for married couples and \$1,000 for single people to \$1,000 and \$500 respectively, we could get \$3,400,000,000 from this tax alone. If the surtax rates were altered so that the lower and middle surtax brackets paid considerably more—according to perfectly reasonable schedules worked out and presented in this report and at the same time the credit for dependents was lowered, the total available from the personal income tax could be made to reach \$7,000,000,000 on the basis of 1928 incomes. "Obviously," says the research staff, "such a schedule would be considered only in the event of an extreme fiscal crisis." (Page 77.)

In this volume, *Facing the Tax Problem*, the rest of our existing major federal taxes are treated in a similar way. The federal corporation income tax could be made to yield, even as it now stands, something like \$2,600,000,000 in an income year like 1928 (page 85.) The estate tax might be made to bring in something like a billion dollars in a good year if rates were increased all along the line (page 87). The federal gasoline tax could probably be increased by

another cent without decreasing consumption appreciably, and the return ought to be another \$150,000,000 or \$200,000,000 (page 90.) And so on, through less important taxes with smaller possibilities of expansion, but this is a place where every \$100,000,000 counts.

These are not recommendations. They are merely statements of the possibilities in highly prosperous times. As such, they offer a certain amount of help in the fourth part of my problem, that of foretelling the kind of taxes that congress in its wisdom is going to elect to use. For if congress decides, or is impelled from above to decide, that no new taxes of importance are to be installed, it is comforting to be told that the existing federal tax system, excluding the social security taxes, could be made to yield \$8,200,000,000 if one of the next few years were a peak prosperity year generally similar to 1928. (Page 124).

The committee on taxation *has* a definite recommendation: namely, that the base of the federal personal income tax be broadened and its weight on existing taxpayers slightly increased by lowering the exemptions. But since the committee recommends that "the lowering of exemptions be made in such a way that the total tax burden being carried by persons with low incomes will not be increased" (page 454) that is, that the tax liability of such persons in other directions should be reduced, the recommendation is of little help to me in the emergency I face today, much as I welcome it from the point of view of just fiscal policy.

My own comments on the estimates of the Twentieth Century Fund experts is that they are too good, and the authors are too good. What assurance have any of us that congress is going to stick to the taxes that we have tried and found acceptable? That it is going to stick to the approved version of the income tax, or the cheerfully-endured gasoline tax? My task today is not to deliver *pronunciamientos* as to what I consider fine federal taxes, to be administered in a gentlemanly way, but to guess at the effects of those taxes that I guess congress is going to use. And my guess is that congress may think of some taxes that I should never have guessed it would think of.

Italy, I hear, has had great success with a tax on bachelors. At least the number of bachelors has been greatly reduced within a year. I have not been advised as to the fiscal effects of the tax. But such a tax rouses speculation. If a bachelor marries and has a family, he gets greater exemptions and credits under the income tax. Bachelor tax receipts fall and income tax receipts fall. Peter is robbed to pay Paul, and Paul loses his money.

A capital levy is not out of the question, I suppose. Certainly it was very generally used in Europe after the end of the World War. Even Great Britain put an inland revenue committee to work on a possible schedule of rates for that country. Parliament, it appears, thought twice about it, but it was a rather close call. The latest

device in Italy, as far as I know, is an extraordinary capital levy on all stock companies and an increase in the sales tax. And, speaking of the sales tax, is a general sales tax outside the range of possibility?

If we are going to be as realistic as it is possible to be while we are engaged in the business of fortune-telling, we must admit that we do not know and cannot know what kind of taxes are to be used to accomplish this "substantial debt retirement" of something like a billion dollars a year. But, whatever they are, my guess is that the incidence will be largely on the lower and middle classes. Even the experts of the Twentieth Century Fund, who have allowed their imaginations pretty wide scope, within the limits of the existing federal tax system, have been inclined to leave the top brackets alone. If new taxes or increased rates involve lower exemptions for single and married people and smaller credits for dependents, or higher gasoline taxes, or a general sales tax or a tax on bachelors, it is the common man, the ordinary citizen, who is going to pay.

The long-run social effects of that additional burden upon the lower and middle economic groups will necessarily be the reduction of the purchasing power of the members of those groups. They will buy fewer cars and pay less in manufacturers' excises. They will buy fewer gasoline taxes and the gasoline tax receipts of the federal government will fall. The new lowered limits of the personal income tax will produce less than anticipated because of the increased deductions on account of other taxes paid. The budget will soon get out of balance, the deficit will reappear, and the federal program for debt retirement will have to be abandoned. We will be back where we were. My task is still undone. Substantial debt reduction has been accomplished for only a brief period.

But wait. New taxes will not be needed at all if we get back to the prosperity of 1928. The old rates, we are assured, would yield more than \$8,000,000,000 in such a time of boom. Now we only need to foretell accurately the course of the business cycle—my sixth problem. Here I must admit to a certain confusion, and the Twentieth Century Fund is not helping me. I look to Major Angas, and he tells me that the administration has and will shortly again turn on the inflation current and that business is to be good, very good. I look to Mr. William J. Baxter, and he tells me that liquidation is going further and the depths of deflation are yet to be sounded. It seems to come down to this: we may need some new taxes for substantial debt retirement, and then again, we may not!

But I shirked part of my fifth problem, which was to foretell and analyze the effects of the new taxes upon the farmer as distinct from the wage-earner, upon the employer, upon the national income, upon the standard of living, upon personal initiative, and upon the international position of the United States. If we have a boom we shall not need any new taxes and there won't be any effect. But we might have new taxes without needing them—congress has done stranger things.

All I can say is, if we don't have a boom, or if we do have a boom and congress doesn't know it, the outlook is extremely gloomy. Logic, working upon facts, indicates that the budget can never again be brought permanently into balance, the national debt can never be substantially reduced, the standard of living for all but the richest in the United States must permanently fall and we are headed for a speedy decline among the nations.

In "I'd Rather be Right" the president says, "The trouble with this country is that I don't know what the trouble with this country is." The trouble with my forecasting is that I don't know what the trouble with my forecasting is. I only know that I don't believe a word of it.

CHAIRMAN GERSTENBERG: Thank you, Dr. Comstock.

The next talk is going to be a very interesting one, I presume, for the taxpayers. I suppose their interest will remind them of the story of the banker with the glass eye. If the tax gatherers have to pay taxes they may have some sympathy even if they have a glass eye. The subject is, "The Problem of Intergovernmental Exemptions."

When the executive committee decided that it would hold its meeting at the home of Mahomet, the program committee decided immediately that we would have to have some contributions from Washington, since we had come very close to Washington. Of course, the one person that we thought of was ex-president Tommie Adams, of the treasury department.

Dr. Magill was asked to present a paper this morning and in his usual generous way he accepted, and, in his very generous way, he decided on a subject that he thought would be most interesting to us. Then, in a superlatively generous way, after having prepared part of that, he realized that the subject finally selected would be more interesting. So he asked Mr. Query whether he could substitute that subject, and you will have discussed this morning the subject, "The Problem of Intergovernmental Exemptions."

Of course, we all know Dr. Magill. He is, like Dr. Haig, a professor at Columbia University. He was special chief counsel to the treasury department. Then he occupied the position that our dearly beloved Tommie Adams occupied, and now he is the Under Secretary of the United States Treasury.

I introduce to you Dr. Magill.

ROSWELL MAGILL (District of Columbia): Mr. Chairman and Gentlemen: The reason for my topic is a different one from that which Dr. Gerstenberg has given you. Having ascertained that Dr. Haig was going to take care of the subject of tax administration, by proposing the unique idea of eliminating Scotchmen from the top positions, and that Dr. Comstock would take care of the tax situation

which happens to be troubling me right now by the unique contribution of attacks on bachelors, which I had not heretofore thought of, I was left free to deal with some of the less important and some of the minor considerations, such as the problem of tax-exempt bonds, state and municipal salaries, and the like. That seemed like less dangerous ground for me to tread on for whereas Dr. Comstock might talk freely about attacks on bachelors, unfortunately, I can talk less freely about it now than I might have been able to do a year or so ago.

THE PROBLEM OF INTERGOVERNMENTAL TAX EXEMPTIONS

ROSWELL MAGILL

Under Secretary of the Treasury

The history and scope of the intergovernmental exemptions from taxation have been discussed and defined so often that it is quite impossible for me to give this gathering of experts any new light upon these topics. Notwithstanding the unanimous recommendations of successive presidents and secretaries of the treasury for twenty years, the exemptions remain unchanged, except for the judicial embroidery which has been added to the original design blocked out long previously. The persistence of the original design might lead an observer from another planet to either of two conclusions: that the doctrine of intergovernmental exemptions is basically sound, and its modern development a logical necessity; or that whether sound or not, the doctrine, having been developed by the supreme court, and not the congress or the state legislatures, upon the basis of the necessary, though unexpressed, implications of the constitution, is practically incapable of modification or repeal under our constitutional system. The current agitation for change, which has led to many proposals for constitutional amendments and legislation, make a discussion of these two latter propositions appropriate. I intend to discuss only the intergovernmental exemptions of interest and employees' compensation, and not to touch upon such questions as the exemptions of sales of articles intended for essential governmental use,¹ or of private lessees' incomes from government-owned property.²

1. The doctrine of the immunity of federal instrumentalities from state taxation had its origin, as you know, in the great case of *McCulloch v. Maryland*,³ which involved a substantial tax imposed by the state of Maryland upon bank notes issued by banks not chartered by the state and applied to notes of the Bank of the United States. In holding the tax invalid, Mr. Chief Justice Marshall spoke

¹ *Indian Motorcycle Co. v. U. S.* (1931) 283 U. S. 570.

² *Burnet v. Coronado Oil & Gas Co.* (1932) 285 U. S. 393.

³ (1819) 4 Wheat 316.

in terms of sovereignty—that “the sovereignty of a state extends to everything which exists by its authority, or is introduced by its permission”; but does not extend to “means employed by congress to carry into execution powers conferred on that body by the people of the United States.” By relying upon this principle, Marshall said, “We are not driven to the perplexing inquiry, so unfit for the judicial department, what degree of taxation is the legitimate use, and what degree may amount to the abuse of the power.” Rather, a clear-cut line could be drawn. Moreover, since “The power to tax involves the power to destroy,” the chief justice concluded that any exercise of the power whatever was invalid.

To this brief epitome of Marshall’s reasoning, it is proper to add two other possible bases for the actual decision: (1) that the bank had been created by the United States as an agency to carry out certain of its fundamental powers; and (2) that the tax was evidently aimed directly at the Bank of the United States, and was discriminatory in character. The first point was relied upon in the opinion; the second, though evidently in the background, is not given express significance. That it was not very significant in Mr. Chief Justice Marshall’s mind was shown ten years later, when, in *Weston v. City Council of Charleston*⁴ a property tax on interest-bearing obligations was held inapplicable to obligations of the United States owned by individuals.

Two other cases complete the early history of the subject. In 1842, in *Dobbins v. Commissioners of Erie County*⁵ the captain of a United States revenue cutter was held not subject to a general county tax measured by the value of his office. The decision was based upon the propositions that since the revenue cutter was not subject to a county property tax, its captain was similarly exempt; and that since the state had no power to diminish the captain’s salary, it could not accomplish that result through a tax. However desirable the result, it is quite evident neither conclusion necessarily follows from its premise. Nevertheless thirty years later, in *Collector v. Day*,⁶ the doctrine was extended to a federal tax upon a state official; and the non-discriminatory Civil War federal income tax was held constitutionally inapplicable to a state judge. Thus, the original decision that a discriminatory state tax upon a federal instrumentality was invalid was extended by the process of judicial reasoning first to a non-discriminatory tax of the same character, then to a non-discriminatory tax upon a federal employee, and finally to a non-discriminatory tax upon a state employee. The full circle had been completed; only the details remained to be filled in. A doctrine that the fiscal powers of the United States must be protected against defeat by the states becomes transmuted into a

⁴ (1829) 2 Pet. 449.

⁵ (1842) 16 Pet. 435.

⁶ (1870) 11 Wall. 113.

doctrine that citizens of the United States who happen to earn their living as state officials must be protected against a levy to meet the fiscal necessities of the United States caused by the Civil War.

The modern history of the doctrine of intergovernmental tax exemption in the important field of income taxation stems from *Pollock v. Farmers Loan & Trust Co.*⁷ One of the questions in that case was the validity of the federal income tax as applied to income derived from municipal bonds. The justices, divided on other points, all agreed that the tax was invalid. Mr. Chief Justice Fuller summarized the conclusion thus: "It is obvious that taxation on the interest therefrom would operate on the power to borrow before it is exercised, and would have a sensible influence on the contract, and that the tax in question is a tax on the power of the states and their instrumentalities to borrow money, and consequently repugnant to the constitution." The proposition was thus stated as self-evident, not requiring proof; a necessary implication from the constitution, though not expressed there. Yet only a few years later, the court evidently viewed the proposition as less than fundamental, for it endorsed an evasion of it through the simple turn of a legislative phrase. Congress in 1909 took the first step to hurdle the barrier of the *Pollock* case, by adopting a corporation excise tax "equivalent to" one percentum of the entire net income over and above five thousand dollars received by it from all sources. The court concluded without difficulty that interest on state and municipal bonds could be included in the income forming the measure of the tax; that this was not the direct taxation of the state or thing taxed which the *Pollock* case condemned; and that the mere inclusion in the *measure* of income from non-taxable property, was not objectionable so long as the *subject* of taxation itself was legitimate.⁸ So a tax could not be imposed directly upon the interest on state and municipal bonds, but the desired amount could be collected, from the same taxpayer, if the law were phrased in the terms of an excise or privilege tax, measured by income from all sources, including interest on state and municipal bonds. Yet it is hard to see any real difference between the two situations, so far as burden upon the state's borrowing power is concerned. The fact that so large an exception to the original broad doctrine is made to turn upon a more verbal difference indicates some lack of fundamental reality in the original doctrine.

The necessity for this judicial legerdemain might be thought to have been ended with the adoption of the sixteenth amendment:

"The congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

⁷ (1895) 157 U. S. 429, 158 U. S. 601.

⁸ *Flint v. Stone-Tracy Co.* (1911) 220 U. S. 107.

The congressional resolution as at first introduced did not contain the clause, "from whatever source derived." It is well-known that the amendment was intended to remove the obstacles to federal income taxation raised by the *Pollock* case. Two holdings in that case were that taxes on real estate and on personal property being direct taxes, a tax on the income therefrom is likewise a direct tax; and since the 1894 tax was not apportioned among the states according to population, it was void. The amendment without the clause "from whatever source derived" would have been adequate to overcome these two holdings. The addition of the clause indicates an intention to cancel for the future the further holding in the *Pollock* case that the interest from state and municipal bonds were not subject to the federal income tax, irrespective of the apportionment point. Similar language in the 1909 act had been held by the court adequate to embrace this subject; and indeed it is not easy to devise another form of words more embracing or more suitable for the purpose. Hence it is not surprising that Governor Hughes, as well as other public men, warned that the amendment would extend the taxing power to income previously exempt. The contrary view was also strongly expressed, but certainly the language of the amendment and its history supports Governor Hughes' view.

The court has never been called upon to pass directly upon the power of congress under the sixteenth amendment, to tax the interest on state and municipal bonds. Each succeeding income tax act, from 1913 to date, has expressly exempted the interest upon the obligations of a state or any political subdivision thereof.⁹ The court has many times indicated, however, that in its opinion the amendment did not extend the taxing power to new subjects; but simply put at rest the contention that an income tax, being a direct tax on property, must be apportioned. Mr. Chief Justice White went out of his way to state and elaborate this conclusion in *Brushaber v. Union Pacific R. R. Co.*¹⁰ and *Stanton v. Baltic Mining Co.*¹¹ Mr. Justice Van Devanter repeated it in *Peck & Co. v. Lowe*,¹² and then gave it great emphasis in *Evans v. Gore*,¹³ the first of the series of decisions upon another branch of my topic: the power of congress under the sixteenth amendment to tax salaries. It crops up again in *Willcuts v. Bunn*¹⁴ where, in the course of holding that the United States can constitutionally tax the profit upon a sale of county and municipal bonds, Mr. Chief Justice Hughes said: "In the case of the obligations of a state or of its political subdivisions, the subject

⁹ 1913 Act, par. B. (38 Stat. 114, 166, 168); 1936 Act, Sec. 22 (b) (4). (49 Stat. 1648, 1657).

¹⁰ (1916) 240 U. S. 1.

¹¹ (1916) 240 U. S. 103.

¹² (1918) 247 U. S. 165.

¹³ (1920) 253 U. S. 245.

¹⁴ (1931) 282 U. S. 216.

held to be exempt from federal taxation is the principal and interest of the obligations." There was no occasion for Mr. Chief Justice Hughes to go into that question in detail, for, as he pointed out, the income tax act itself exempted "interest upon the obligations of a state, territory or any political subdivision thereof."

Since congress has not since 1909 taken advantage of the court's sanction of a corporation excise tax measured by income, including tax-exempt income, the present situation is this. The interest on state and municipal bonds is fully exempt from federal income taxation, either to corporations or to individuals. But a profit on their sale is subject to tax, and such bonds are included in the gross estate for the federal estate tax. In the case of an original purchaser, the entire discount at which the obligation was issued is exempt from federal income taxation; and a later holder may be entitled to a *pro rata* exemption on account of discount. There has been a good deal of litigation and administrative difficulty as to the precise types of obligations which fall within the exemption, such as condemnation awards, certificates of ownership in tax-exempt securities held by a trustee, and obligations, like paving warrants and park fund certificates, chargeable against the benefitted owners and not against the municipality. In general, however, the scope of the exemption as it stands is reasonably well defined.

On account of the group of decisions just discussed, the states have been prevented from applying general property taxes to federal bonds, and general income taxes to the income therefrom. The states have, however, been somewhat more astute than has the federal government, in taking advantage of the doctrinal distinction between a direct tax on a tax-exempt subject, and a tax on a proper subject, measured by tax-exempt income. In *Miller v. Milwaukce*¹⁵ a divided court held that Wisconsin could not validly provide that a corporate stockholder should not be taxable upon dividends from corporations, the income of which was assessed; but should be taxable on the dividends to the extent that the corporation had not been assessed. The court thought it detected an attempt to discriminate against holders of United States bonds. For the same reason, in *Maccallen Co. v. Massachusetts*¹⁶ the court struck down a corporation excise tax measured in part by income, which the legislature had later amended expressly to include the interest on federal bonds. But later cases have upheld the corporation excise taxes of New York¹⁷ and California,¹⁸ which were measured by income from all sources, including the interest on federal bonds, on the theory that no objectionable attempt to single out United States bonds was shown. Individuals are still free from state income taxes on federal

¹⁵ (1927) 272 U. S. 713.

¹⁶ (1929) 279 U. S. 620.

¹⁷ *Educational Films Corp. v. Ward* (1931) 282 U. S. 379.

¹⁸ *Pacific Co. v. Johnson* (1932) 285 U. S. 480.

bond interest. Moreover, in order to protect the market for its own bonds, the treasury has exempted about six-tenths of them from the federal normal tax, and four-tenths are free from any taxation, state or federal.

As of July 1, 1937, the net outstanding debt of the United States was \$35 billions upon which the annual interest charge is \$915 millions. The net outstanding issues of states and local subdivisions was nearly \$17 billions on June 30, 1936, and the annual interest charge is estimated at \$718 millions. Since many of these bonds are held by exempt corporations, such as educational and charitable institutions, and by taxpayers not subject to income tax; and since a large part of the interest on the federal bonds is now subject to surtaxes though not normal taxes, the additional taxes which would be due if the tax exemption on these outstanding bonds could be presently destroyed are not as great as has been sometimes supposed. Although exact data as to the distribution of state and local bonds by types of investors are not available, the best information which we have available leads us to estimate that if the federal government were authorized to collect federal income taxes upon the interest on state and local bonds now outstanding, the additional revenue at current levels of income and under the provisions of the present revenue law would be approximately \$70 millions annually.

The existence of this large mass of exempt property and income, however, presents a fiscal problem of greater significance than these figures indicate. Progressive surtaxes cannot be made to operate effectively so long as governments themselves provide this easy mode of escape from them. The exemption is rightly regarded by the bulk of taxpayers as undesirable and unsound. Finally, since federal and state bonds alike are and must be sold to many persons to whom the tax-exemption feature is not important, the interest rate is not reduced by an amount precisely equivalent to the worth of the tax-exemption privilege. The elimination of the tax exemption from some federal and state bonds, but not from others, would no doubt necessitate a somewhat higher interest rate on future taxable issues. If all governmental issues were uniformly taxable like other bonds, the federal and state governments might expect ultimately to gain more in taxes than they would lose in increased interest.

2. The salary exemption—The two early cases previously mentioned, *Dobbins v. Commissioners*¹⁹ and *Collector v. Day*,²⁰ established the propositions that, under the original constitution, the salaries of state and federal officials were respectively exempt from the income taxes of the other governments. For reasons already given, the sixteenth amendment might have been thought to change this situation, so far as federal income taxes on state officials' salaries were concerned. But the supreme court has consistently followed

¹⁹ *Supra*, note 5.

²⁰ *Supra*, note 6.

the view that the amendment did not extend the taxing power to new subjects. Consequently, *Collector v. Day* remained good law. Concealed beneath the broad grant of power to tax incomes from whatever source derived was the old distinction that a citizen of the United States who was also a Massachusetts judge was not subject to the same tax on his salary for the support of that government which was collectible from other citizens of the United States with like salaries paid by private employers. The Massachusetts judge must not only not be discriminated against; he must be given a preferred position over other citizens, privately employed, with like salaries. The federal revenue acts, after the 1917 act, have not expressed this exemption, so the supreme court and the lower courts since then have had to work out its boundaries for themselves. The number of controversies which have arisen on the subject, and the resulting litigation is wholly out of line with its revenue significance.

The supreme court, possibly not wholly satisfied with the exemption itself, has narrowed it in two important respects. Independent contractors with the states must be distinguished from regular employees of the state; and employees in non-governmental activities are not entitled to the exemption. Both exceptions have led the lower federal courts into a wilderness of fine distinctions. Thus, the board concluded that the compensation of a "Special Counsel for the City of Chicago in Gas Matters" was exempt,²¹ but the court of claims and the circuit court of appeals for the seventh circuit concluded that the salaries of real estate experts employed by the Chicago Board of Local Improvements were not exempt.²² The board regarded the salary of an employee of the Delaware River Joint Commission as exempt,²³ but the third circuit court of appeals reversed on the ground that he was an independent contractor.²⁴

The board held that services rendered by the director of the port of Beaumont, Texas, were not shown to be in the discharge of essential governmental functions,²⁵ but it concluded, as did the second circuit court of appeals that the Albany, New York, Port District Commission was a government instrumentality, and hence that its chairman's salary was exempt.²⁶ The board concluded that the salary of a professor in the University of Maryland Law School for 1925 was not exempt,²⁷ but that the salary of a part-time instructor in the same school for 1928 was exempt.²⁸ In the second case, the

²¹ *Richberg v. Commissioner*, BTA, Memo. op. 12-17-32.

²² *Mesce v. U. S.* (1928) 64 Ct. Cl. 481; *Lyons v. Reinecke* (1926) 10 F (2d) 3.

²³ *Com'r v. Modjeski*, (1933) 28 BTA 1051.

²⁴ 75 F (2d) 468, cert. den. 295 U. S. 764.

²⁵ *Wiggins v. Com'r*, (1933) 27 BTA 576.

²⁶ *Com'r v. Ten Eyck*, (1934) 29 BTA 1113, (1935) 76 F. (2d) 515.

²⁷ (1930) 20 BTA 949.

²⁸ (1932) 25 BTA 1385.

petitioner evidently made up deficiencies of proof thought to exist in the first. The board of tax appeals and second circuit court of appeals concluded that the city of New York in operating a water system was not performing a governmental function, and hence that the salary paid the chief engineer of the bureau of water supply was not exempt.²⁹ Five members of the supreme court, somewhat surprisingly in the light of the reasoning in *Helvering v. Powers*,³⁰ concluded that the acquisition and distribution of water is a constitutionally exempt governmental function, apparently abandoning the historical tests which had theretofore been applied.³¹ Other instances could be multiplied. Meanwhile, the bureau has been quite as busy as the courts. The tax service lists thirteen rulings, for example, on the subject of the exemption of the compensation of harbor pilots, bar pilots, and river port pilots. Altogether there have been over 300 published rulings and decisions on this general question, and new cases are being presented all the time. Moreover, the game is hardly worth the candle from the governmental point of view. There are about 2,500,000 state and local employees, but their average compensation is about \$1430, over \$1000 less than the exemption accorded a married person by the federal law. Hence, if they were all subject to federal income taxation, the increased revenue would be, it is estimated, less than \$15,000,000 at the 1936 rates. The litigation is all out of proportion to the revenue significance of the exemption.

If this mass of litigation were gradually leading toward a more equitable tax system, the delay and the confusion could be accepted as the price we must pay for social reform. But no objective observer would contend that the equal operation of the tax system is being improved; or that, if we were starting afresh today, the distinctions worked out in the 300 rulings and decisions should be preserved as fundamental. Mr. Justice Roberts, in the *Brush* case, summed up the situation as follows:

"The frank admissions of counsel at the bar concerning the confusion and apparent inconsistency in administrative rulings as to the taxability of compensation of municipal employees seems to call for an equally candid statement that our decisions in the same field have not furnished the executive a consistent rule of action. The need of equitable and uniform administration of tax laws, national and state, and the just demand of the citizen that the rules governing the enforcement of those laws shall be ascertainable require an attempt at rationalization and restatement."

²⁹ *Brush v. Com'r* (1936) 85 F. (2d) 32.

³⁰ (1934) 293 U. S. 214, in which the operation of a street railway was said not to be a governmental function.

³¹ (1937) 300 U. S. 352.

He then formulated a sound restatement of the constitutional limitations as follows:

"It seems to me that the reciprocal rights and immunities of the national and a state government may be safeguarded by the observance of two limitations upon their respective powers of taxation. These are that the exactions of the one must not discriminate against the means and instrumentalities of the other and must not directly burden the operations of that other. To state these canons otherwise: an exaction by either government which hits the means or instrumentalities of the other infringes the principle of immunity if it discriminates against them and in favor of private citizens or if the burden of the tax be palpable and direct rather than hypothetic and remote. Tested by these criteria the imposition of the challenged tax in the instant case was lawful."

His conclusions as applied to the particular case were these:

"The petitioner is a citizen of New York. By virtue of that status, he is also a citizen of the United States. He owes allegiance to each government. He derives income from the exercise of his profession. His obligation as a citizen is to contribute to the support of the governments under whose joint protection he lives and pursues his calling. His liability to fulfill that obligation to the national government by payment of income tax upon his salary would be unquestioned were it not for the character of his employer."

". . . I think the imposition of a tax upon such gain where, as here, the tax falls equally upon all employed in like occupation, and where the supposed burden of the tax upon state government is indirect, remote, and imponderable, is not inconsistent with the principle of immunity inherent in the constitutional relation of state and nation."

Unfortunately, Mr. Justice Roberts spoke for two members of the court only; five members, as heretofore stated, held Brush's compensation to be constitutionally exempt, while the remaining two justices considered his salary to be exempt under the terms of the applicable treasury regulations. The fact that only a bare majority of the court reached its decision upon the basis of constitutional immunity, and the fact that the court has invited the department of justice to submit a brief in the series of cases headed by *James v. Dravo Contracting Co.*,³² involving state taxes upon the gross receipts of independent contractors engaged in the construction of dams for the United States, may form the basis for a hope that the supreme court will reconsider the whole problem of intergovern-

³² Oct. Term, 1937; on appeal from the Dist. Ct. of the U. S. for the Southern Dist. of W. Va.

mental tax immunity. No constitutional amendment could be framed to accomplish so broad and so desirable a result as the adoption by the court of the general position which Mr. Justice Roberts outlined. As one aspect, consider how much the administration of the federal income tax would be improved, if the sixteenth amendment were now held to mean what it says—to confer the power actually to tax incomes from whatever source derived.

If the supreme court follows the course of adherence to past precedent, legislative reform must follow either the laborious course of a constitutional amendment, or the hazardous course of a statutory enactment which may or may not be held to be valid. It would be difficult to draw an amendment to eliminate all the present subdivisions of inter-governmental tax exemption; and difficult to obtain its adoption by three-fourths of the states, some of which would have little or nothing to gain thereby. It seems fair to say at this point that if the federal government is permitted to tax the compensation of state employees and the interest on state obligations, the states should have a corresponding privilege to tax federal salaries and bond interest.

The newspapers recently quoted President Nicholas Murray Butler of Columbia University as saying that for the congress to propose an amendment to authorize the taxation of the interest on state and municipal bonds, and of state and local officials' salaries, would make this country the laughing-stock of the world, since the sixteenth amendment clearly contains the authority already. Nevertheless, the treasury in recent years has advocated the constitutional amendment rather than the statutory method of change, primarily to remove any doubt of the validity of the proposed tax, when imposed, with the possible unsettlement of the bond market while the test cases were proceeding through the courts.

Aside from the outright repeal of the present statutory exemption of state and municipal bond interest from federal income taxation, at least two other less sweeping changes present themselves. The congress might adopt again the method approved in *Flint v. Stone-Tracy Co.*:³³ transform the corporation normal tax on income into a corporation privilege tax, measured by income, including interest from all sources. Such a change would bear with particular severity, of course, upon financial institutions with large holdings of state and federal bonds. Moreover, since the present exemptions have a twenty-five year standing, congress would have to decide whether any change should apply only to the interest on future issues of bonds; or to the interest on all issues received after the effective date of the law. Similar changes by the states have taken the latter course.

As to individuals, the congress might adopt the general idea sanctioned by the court in a different connection in *Maxwell v. Bugbee*:³⁴

³³ *Supra*, note 8.

³⁴ (1919) 250 U. S. 525.

take all tax-exempt income into account in determining the rates to be applied to the individual's taxable income. Or to put it another way, instead of treating an individual's taxable income as subject to the lowest rates in the surtax scale, and thus his tax-exempt income in effect as excluded from taxation at the next higher rates, reverse the process. Place his tax-exempt income at the bottom of the surtax scale, and super-impose his taxable income thereon. The tax-exempt income would not be taxed; and the taxable income would be subjected to the higher rates applicable in the light of the taxpayer's entire income status.

This proposal was advanced by Secretary of the Treasury Carter Glass in his annual report for 1919, in which he said:

" . . . I call attention to the urgent necessity of revision of the revenue law so as to require that, for the purpose of ascertaining the amount of surtax payable by a taxpayer, his income from state and municipal bonds shall be reported and included in his total income, and the portion of his income which is subject to taxation taxed at the rates specified in the act in respect to a total income of such amount. . . . It is intolerable that taxpayers should be allowed, by purchase of exempt securities, not only to obtain exemption with respect to the income derived therefrom, but to reduce the supertaxes upon their other income, and to have the supertaxes upon their other income determined upon the assumption, contrary to fact, that they are not in possession of income derived from state and municipal bonds.

" A question has been raised concerning the right of the federal government under the constitution to tax the income from state and municipal bonds, but there can be no doubt of the constitutionality of such an administrative provision. The proposal is not to tax the income derived from state and municipal securities, but to prevent evasion of the tax in respect to other income. The principles involved are abundantly established in the decisions of the supreme court sustaining taxes upon corporations, bank stock, etc., computed after taking into account income derived from government, state, and municipal bonds."

The validity of the proposed provision is not assured, in the light of prior decisions of the court;³⁵ but since it is inherently fair, and eliminates glaring inequalities in our present system, the proposal certainly merits the most careful consideration.

Some of these alternatives are now pending in congress, notably a series of constitutional amendments, differing in scope, which have been referred to the judiciary committee of the senate. The present situation is difficult and confused, and presses for a prompt solution. Since the members of the National Tax Association are at once

³⁵ See particularly *Nat'l Life Ins. Co. v. U. S.* (1928) 277 U. S. 508.

familiar with the problem, and concerned with its present effects, I venture to ask the application of your individual and collective intelligence upon it.

CHAIRMAN GERSTENBERG: We are all very much indebted to Dr. Magill for his address this morning.

May I make a few announcements? The secretary is here but since he has already asked me to make these, I shall read them.

The Kiwanis Club meets today at the Emerson Hotel at 12:15. Visiting Kiwanians are cordially invited to attend.

We have a few copies of Dr. Lavery's paper which he presented last night left on the desk if anyone cares to have a copy.

I call your attention again to the round table luncheon and also to the very interesting program of this afternoon and this evening.

Now, gentlemen, it is very early in the morning and if there are any people here who care to discuss any of the papers there will be ample opportunity to do so. Perhaps we had better, first, have a seventh inning stretch during which you can come up and get your papers.

Is there any discussion of any of the three papers—the first one by Dr. Haig? Are there any questions you wish to ask Dr. Haig?

May I inquire if there is anybody in the room who knows of the Canadian situation and the work of its royal commission which is studying the same subject, or who cares to make any remarks on the prospects there?

Is there anybody here from the University of Minnesota? I understand several professors there have made parts of a study that have been sent to that royal commission.

A. K. EATON (Ottawa, Canada): In regard to our dominion-provincial relations, I think it might be appropriate to give you the information that we—the government—have recently appointed a royal commission to go into this whole problem of dominion-provincial relations, and to make recommendations with respect not only to taxation powers between the various levels of government, but also on the distribution of functions, and also on the question of constitutional amendments.

The commission has recently started its work and we make no prophecies as to when it will report, but it is apparently going about it in a very thorough manner and its findings I think will be of interest to this body.

I might also make some comment on the subject that Professor Haig presented this morning by merely saying that Canada has taken steps somewhat similar to those taken in Australia. They grew out of voluntary conferences, in the direction of cooperation, between the dominion minister of finance and the treasurers of the provinces.

We have had dominion-provincial conferences which covered the general scope of government activities, but this was narrowed down to purely voluntary and unofficial conferences.

We called it the national finance committee, which with very little fuss and publicity attempted to obtain some voluntary cooperation between the financial authorities in the two levels of government. And out of these meetings grew some cooperation of the kind mentioned by Professor Haig as existing in Australia. The result has been that for the past two years the dominion government has been collecting the income tax for the province of Ontario.

For example, I live in Ottawa. Ottawa is in Ontario. I pay my income tax to the dominion and to the province of Ontario on one form. One check and one return takes care of both taxes.

That has been brought about by the Province of Ontario accepting the dominion's definition of taxable income, or its definition of income, so that the whole form is the same for both, practically the whole form, with the exception of a little additional paragraph of about two inches which is filled out for the province of Ontario, and the whole thing is completed in the one return.

I have not had anything to do with the administering of this tax. I am in the finance department rather than in the department of national revenue which administers our tax, and I wish our commissioner were here to explain to you and comment on the workings of this arrangement.

I might say that our own commissioner and the commissioner in Ontario seem to be working together and they are both highly satisfied with the arrangement.

Negotiations are now under way for the same form of cooperation to extend to the province of Manitoba, the province of Prince Edward Island, and I think possibly the province of Saskatchewan. The same arrangement is being undertaken in those provinces. This form of cooperation is as I say being currently worked out but at the same time we have this royal commission which is going to report quite thoroughly on the whole situation.

CHAIRMAN GERSTENBERG: Dr. Eaton, is there any time set for that report?

MR. EATON: No, sir.

FRANKLIN S. EDMONDS (Pennsylvania): May I ask a question?

Is there not also a tax revision council that was appointed, I think, by the secretary of the treasury, made up of representatives of federal government and also of the state governments, and has that body any plans or conclusions to present?

CHAIRMAN GERSTENBERG: Dr. Magill, do you know about that?

ROSWELL MAGILL: I am not fully advised on that. I think there is such a council. I am not sure of the manner of its appointment, and I do not know when it is to report.

MR. EDMONDS: Do you know what its subject is? Is it this question of federal-state relationships?

MR. MAGILL: Yes, sir.

CHAIRMAN GERSTENBERG: I thought that Dr. Comstock had linked arms with Spengler and was taking us to a very unhealthy place. Perhaps somebody would care to comment on that situation.

I wonder if you remember that as short a time ago as eleven years we gave back taxes to people. I wonder who remembers on what occasion and under what circumstances we gave taxes back to the people—not because they were erroneously or improperly collected, but because, having paid them, we decided they paid too much as a class and we felt that we were prosperous and should give the taxes back.

How about that, Senator?

MR. EDMONDS: Are you referring, sir, to the 80 per cent?

CHAIRMAN GERSTENBERG: No, I am referring to the cancellation of the 1924 gift tax in 1926 and the refunding of the excess of the 1924 rates over the 1926 rates. That was done by a Republican government, you remember. I thought you certainly would arise to that occasion.

PRESIDENT LESER: Do you know that in 1837 the federal government distributed a dividend to the states of its surplus?

CHAIRMAN GERSTENBERG: That was by a Democratic government.

MR. EDMONDS: That certainly was, and in Pennsylvania we used it to build public schools. The school which Judge Leser and I attended in Philadelphia was built from that federal money.

I have been very much interested, Mr. Chairman, in these discussions and if nobody else wishes to discuss the subjects presented I should like to. I want, first, to say a general word.

I think we all owe a great deal of thanks to the people who have presented papers this morning, yesterday, and the day before, not only for the matter that they contained but, frankly, for their literary excellence. I think there is developing in this association a spirit which is making the discussion of taxation interesting not only to those who know something about it but, in addition to that, to the general public, and I want to say that papers like those we have had during the last two or three days contribute very largely to that end. I shall regard the volume that is issued from this Baltimore conference as a very precious volume.

Now I want to say that, personally, I was very much impressed in the discussion last night by a remark Mr. McDowell dropped, in which he described the sense of bafflement and frustration with which businessmen were regarding their tax problem in this country. I find that spirit growing, and growing tremendously. And, frankly,

it seems to me that there must be some pressure brought in the matter or we will not have the degree of ingenuity, leadership, and risk that has characterized American business in the past.

I was talking with the representatives of a small manufacturing concern in my own city and they called attention to the fact that within recent years there has been such a development in taxation that they are now required, although they have but one manufacturing plant, to file 281 governmental reports, which is practically one report for every working day of the year, and in the preparation of those reports a considerable staff is required.

That is a concern which would like to compete abroad. It produces a highly developed electrical product which is needed abroad, but it finds itself face to face with a basic cost in America, to find out what their tax liability will be, which is simply staggering. Consequently, that firm shares in Mr. McDowell's sense of frustration and bafflement as to how taxes are to develop.

I think, myself, that Dr. Haig's most interesting study possibly points out something to us. He has made the suggestion, I should judge from his Australian experience, that maybe in some way, plans could be developed whereby these state authorities might aid the federal authorities in their collection, and the way in which that would promote unity and uniformity in dealing with certain tax matters.

There have been other suggestions advanced: that maybe the federal officials could help the states in their financing problems. Those plans have been before us for consideration. But I am thoroughly convinced in my own mind that the complication of the tax structure is acting today as a deadweight on the progress of economic recovery for this country, and unless the wisdom that is represented in this room can work out something which is better, simpler, more direct for the taxpayer, it looks to me as if what will eventually happen will be that the taxpayer—the heavy taxpayer—will gradually disappear, and the 1928 income, which Miss Comstock anticipates, will never be upon us again.

It seems to me that we have touched in these last two days the big problem of the country today and I think that those who have taken part in the program have made a most auspicious start in the way of suggestions.

CHAIRMAN GERSTENBERG: I think we ought to say at this particular moment that not only have the papers been exceedingly excellent but that Senator Edmonds' extemporaneous talks are so exceedingly excellent that few of us care to talk after him. Please let none of us be afraid of that. He has had a lot of practice, and if you will speak as much as he does you will get the practice and you will arrive there. So let us have some more discussion.

HARLEY L. LUTZ (New Jersey): I am not going to attempt a speech, after the senator, and your comments on the matter. I rise simply to ask Dr. Magill a question, if I may, which is on a point that has often troubled me in dealing with this question of mutual taxation of instrumentalities. Perhaps Dr. Magill can solve this particular difficulty which is that the great disparity of tax rates between the average state income tax plan and the federal income tax plan seems to me to present a rather serious difficulty in arranging for mutual taxation of bond interest, let us say, between the state and the federal governments.

Possibly I am exaggerating that but I should like to have Dr. Magill, if he will, present his view as to how that discrepancy and difference arises in what the state can get in the way of taxing federal bond interest and the rate at which the federal government may tax state and local bond interest.

MR. MAGILL: I think the man who really should answer that is Professor Haig, because I don't think I touched on that subject at all, but rather I anticipated somewhat the difficulty which you have in mind, even in connection with such a proposal as ratification of a constitutional amendment.

What I intended to discuss here was the question of whether or not these fetters that bind us really cannot be broken, or whether some means can be adopted toward that end; knowing that Professor Haig was going to discuss the possibility of mutually pleasant relations between the state and federal tax administrations, I didn't go into that, and whether or not he is more sanguine than I on that he will have to tell you.

MR. LUTZ: Isn't that, Dr. Magill, really the crux of the matter?

MR. MAGILL: I think not.

MR. LUTZ: State income taxation goes up to 6 per cent and the federal rates go up to ten times that, or more, and if the constitution is to be changed to permit the federal government to tax bond interest, as you pointed out yourself, some equitable arrangement for the state taxation of federal bond interest would naturally have to be offered, or it is difficult to understand how the states would accept the amendment. But doesn't that in itself present a very serious difficulty? If the states, naturally limited as they are to the level of their rates, can impose only a very moderate rate on federal interest, why should they ever concede the opportunity to the federal government to impose its present scale of income tax rates on their own state and local bond interest?

MR. MAGILL: I think you have successfully answered your own question. I tried to say the same thing, but not so effectively, in this paper, and perhaps in the printed document you will see that,

speaking merely as a lawyer, as I am unfortunately not an economist, I suggested a series of other legal possibilities because of the difficulty which, I agree with you, exists as to the possibility of getting an amendment ratified.

PHILIP ZOERCHER (Indiana): I should like to ask a question in reference to what my good friend Senator Edmonds said. We heard what he said about the New Deal. But how is it possible that any firm has to make 281 reports? Can you tell us, Dr. Magill?

MR. MAGILL: They don't make them to me—I know that.

MR. ZOERCHER: He might have to make them to the state of Pennsylvania. The inference is left that they are all made to the United States government.

MR. EDMONDS: Some of them go to Indiana. Those are both state and federal returns that they have to make.

PAUL J. WIMSEY (Illinois): On this question of taxing federal and state government employees, I wonder if the fact has been considered—I presume it has—that the increased tax would necessitate increases in wages which the state and federal governments would have to pay, so that when you are through worrying about all this problem you are right back where you started because you are taking the money out of one pocket and putting it in another. Is that true?

MR. MAGILL: We have thought of that occasionally when other matters did not press upon us and our net conclusion, with which you may not agree, is that we would both be the gainers.

MR. WIMSEY: You would both be the gainers? Where would the employee gain by that?

MR. MAGILL: I cannot tell the states how to raise their employees' salaries to meet the tax but the feeling I have expressed, as you know, is that it seems highly undesirable that there should be this very large mass of citizens in our midst who are not required to aid in the support of the government to which they owe their allegiance. If it is a matter of raising their salaries to enable them to provide that support, why, all right, that is a second question.

MR. WIMSEY: I presume the advantage then would be psychological rather than material.

MR. MAGILL: No. I gave you two figures in here as to the amount of estimated net increase in revenue which would result from this source—and we estimate there would be a gain, so far as the governments are concerned. I cannot tell you about the individual employee.

CHAIRMAN GERSTENBERG: You must remember that if we took in each other's washing, we would at least have clean clothes.

Was there another question back there?

M. D. BACHRACH (Pennsylvania): Folks, as a new comer, I imagine I am displaying a powerful lot of crust by getting up here to make a few remarks, being only a C. P. A. from back in Pittsburgh, western Pennsylvania, but in the course of a public accounting practice emphasizing the preparation of tax reports we gather from our business men back home certain ideas. Therefore, I thought you wouldn't mind if I took just a few minutes to tell you what the people think and what they say. It might also serve the purpose of rather balancing up this program which has thus far been made up entirely of experts, and now you will have a chance to hear from the other side.

Particularly am I happy to have a chance to make these remarks in the presence of Mr. Magill because every practicing tax man would like an opportunity to tell him what is wrong with our tax system and how to fix it.

I think every representative of the taxpayers in the United States that has practiced over a period of years has come to the conclusion that the average taxpayer wants to do the right thing and pay a fair tax. If there is one thing that my people back home cannot understand it is why in a population of 130,000,000 there are only 6,000,000 tax returns filed a year. They believe that it is only fair that even the smaller salaried wage earners should contribute something to the federal government. They don't think that because a man has two or three children, he should pay less tax even though, because of his larger family, he gets more of the benefits of our government.

If I may make this one suggestion, I shall be stating in brief what I have been told over and over again by business people back home. Why does not the government establish some kind of a maximum limit in the ratio between the amount of the tax and the amount of the income? In other words, why isn't it possible on our federal income tax blanks, both individual and corporation, to add one more line down below, after you have figured the amount of the tax, "This amount shall not exceed blank per cent of the net income," be it 20 per cent, 30, 40 or 50 per cent?

Many of the complexities of the capital gains and the reorganization features and other complicated features of the tax law would have less significance if the individual and the corporation knew that, no matter how many windfalls or how many lucky breaks, the most they would be asked to contribute to the government in any one year would be, say, 25 or 30 per cent of the income for that year. And if the federal government would ever make that move I think the states might be encouraged to follow a similar procedure. There is nothing in the opinion of my people at home that would stabilize business more and definitely clear the atmosphere than some kind of a top limit.

The chairman mentioned awhile ago that the national debt averages \$300 per individual in the United States. I think it would be

a good idea for some of us to just send in a check for \$300, with a letter to Uncle Sam saying, "I am paying my share of the debt and I don't want to be bothered any more."

With further reference to my last recommendation about the top limit I might even add the thought that there might be a minimum tax that every individual should pay. In other words, on the individual returns there should be no such thing as sending in a tax blank without some tax payment, even if it is a small minimum amount.

In order to further emphasize and prove the desirability of this top limit may I refer to an incident that occurred 3500 years ago when Moses took the children of Israel out of Egypt into the wilderness and there prepared to establish a government. He knew that in order to maintain this government it would be necessary to impose taxes and he therefore decreed the tithe, and the tithe there was 10 per cent of one's production of the fields, of the crops produced during the year. Today as we look back at that 10 per cent we realize how reasonable it was.

We don't expect a 10 per cent limit here, but the folks back home do feel that it would be wise to have some top limit.

A. J. MAXWELL (North Carolina): May I be permitted to make an announcement, please, Mr. Chairman? I trust it will not seriously interfere with this very interesting discussion.

The committee on resolutions, by its action, was to meet at this time in the room on the right. I trust the members of that committee will as quietly as possible slide behind these curtains and meet in this room.

CHAIRMAN GERSTENBERG: Is there any further discussion?

W. R. BRADLEY (South Carolina): I just want to ask one more question of Dr. Magill.

When it came, Doctor, to the taxation of employees of the Federal Land Bank down in Columbia, naturally, I approached it with fear and trembling, wondering whether it could be done or not, and I found a precedent either in one of the Dakotas or in Nebraska where the state established a land bank and where the officers of the bank, under the law, were appointed by the governor, and the question of taxation by the federal government of these officers came up. The dictum of the court was that they did not fulfill the necessary function of state government and were, therefore, taxable by the federal government.

I thought I had these boys in Columbia then; so I taxed them, and they took me to court. It was a similar institution, there was no difference whatsoever in the machinery, except that one is federal and the other is a state institution but, in South Carolina, the Federal Land Bank employees are, according to the dictum of the court, necessary functions.

I should like for you to tell me—it has worried me for some time—why is it not a necessary function in Nebraska and it is down in South Carolina.

MR. MAGILL: I think that is a fair question.

Of course, I have a practice here probably of turning these shafts to my own account. You are illustrating I think the judicial confusion to which I devoted part of my observations here this morning. That is, as you have said, it was extremely difficult for you, as it would be for anyone else, to decide whether or not this employee of this federal land bank was to be subject to this South Carolina income tax.

You no doubt had decisions, as you suggest. I don't know either of the cases to which you refer. I presume likewise that whatever federal tax collector brought up the question of the taxation of the chairman of the Albany Port Authority thought that the Beaumont, Texas case would do him a lot of good, where there was a similar employee who had been held taxable, but he found it different. In other words, it is a matter of extreme difficulty not only for the tax commissioner, but for the courts themselves to draw a line between essential governmental functions, and to determine what constitutes essential governmental functions, and the courts differ among themselves, to answer your question directly.

You may have read the Panama Railroad case which the supreme court decided some time ago before the more recent Brush case, in which there seemed to be some language at various points to indicate that the taxing power of the federal government in this particular case was broader than the taxing power of the state government, the same sort of an idea that Chief Justice Marshall expressed in *McCulloch* against Maryland: that in the case of general government, as he used to call it, the taxing power ought to extend to employees, say, of the North Dakota Land Bank but there was not the same argument in favor of the taxing power of North Dakota upon the federal instrumentalities which, as he regarded them, were set up by all of the states. And he thought of it in terms of an imposition by one state upon an instrumentality which it had not established but which had been established by the joint action of all.

The supreme court so far I can see from the Brush case doesn't accept that particular distinction. So whether or not the supreme court would make this distinction which you tell me was made in your cases is a matter, as far as I am concerned, of doubt.

MR. BRADLEY: I see.

PRESIDENT LESER: I think I can throw a little light on that question.

I think the case that the gentleman from South Carolina refers to was the case of *Bank of North Dakota v. Olson* which involved the right of the federal government not to tax an employee of the bank

but to tax the bank. This bank had a capital of \$2,000,000, all of which was owned by the state of North Dakota, and its board of directors consisted of officers of the state. Its object was to finance state propositions, to aid agriculture, commerce, and other public benefits.

The case was tried before the federal court and the federal court, applying by the way, the South Carolina decision in the dispensary cases—misapplying them, if you may allow me to say so, in my judgment—held that that bank was subject to the federal tax. The circuit court of appeals affirmed that ruling and the supreme court declined to act upon it. It refused a certiorari.

I have often expressed my disappointment at that because it has created a situation of inequality as between state banks and federal banks.

National banks in other words, although organized primarily for purposes of private profit, with merely incidental federal powers, which up to a few years ago were not even exercised, have been given a preferred position as federal instrumentalities as against this North Dakota bank which performed for the state precisely the same functions, or even in a great degree the functions that national banks perform for the federal government.

H. K. SEIDMAN (Tennessee): I am glad the argument here is of a good-natured sort because my question is likewise directed at Dr. Magill.

It would seem to me that this bond question must be tied in with the provisions of the social security act and, if I remember correctly, those funds must be invested in government issues. If the statements made by various individuals are correct, the fund will in a comparatively short time exceed our present federal bonded indebtedness, and since the supreme court has held the act to be constitutional we have to look for one of two things: either an increased federal bonded indebtedness or a source of investment other than federal securities, federal issues.

It would seem, therefore, that there is some inequity in the fact that the government will eventually own all of the federal bonds and then will turn around and tax individuals owning state obligations. It would seem, therefore, that if some method could be evolved whereby the social security funds are likewise invested in state obligations, the entire question of tax-free obligations is solved immediately.

MR. MAGILL: Also, as you notice, it solves Miss Comstock's problem.

M. M. DAUGHERTY (Delaware): Three hundred and sixty-four days out of the year, what I do and think and say is of no importance to anybody, but on one day in the year I am an important fellow and that day is the 15th of March. The reason for that is I get

my money from the state government who gets its money in my particular case from the federal government.

I am important in a way after that date because both governments say I am an employee of theirs and therefore must pay an income tax to each one.

Up to a couple of years ago the bureau of internal revenue handed down decisions saying that I was a state employee and therefore not taxable by the federal government. A couple of years ago the federal government said that they changed their opinion altogether and that I am their employee and therefore shall pay.

In support of that I was given a long list of decisions all the way up and down the line, and I was thoroughly convinced that I was an employee of the federal government.

What does the state do? They get a long list of decisions, and thoroughly convince me I must pay them. And so, for one day in the year, I am an important fellow.

H. D. SIMPSON (Illinois): I was just thinking if we have Mr. Magill's and Miss Comstock's problems solved, I should like to try to ease Professor Lutz' worry that the federal government will get more revenue from the states by mutual exemption. I should like to throw out this suggestion: if the federal debt continues to increase at the rate at which it has increased in recent years, isn't there at least a gambling possibility that even a 6 per cent state rate on federal interest may yield as much revenue as a 75 per cent federal rate upon the states?

MR. LUTZ: I am not sure, Mr. Chairman, but what Professor Simpson underestimates the capacities of the states and the local subdivisions in that race for competitive indebtedness.

MR. EDMONDS: I should like to ask Dr. Magill if it isn't true that one of the amendments that is pending before the senate judiciary committee provides for reciprocity between the federal government and the states in the taxation of the bonds of each, but that another of the amendments gives the power to the federal government, without any reciprocal power to the states?

MR. MAGILL: That is true, and congress has endorsed the first and not the second. I think Professor Daugherty's suggestion perhaps a better one, and I wish I had thought of it before I wrote my paper. You see, the way out is for the federal and state governments to employ the same set of officials, and then they can both tax.

CHAIRMAN GERSTENBERG: We have the round table scheduled at 12:30 and I think if there are no further discussions we had better declare the meeting adjourned so that every person who cares to attend the round table may do so.

The meeting is adjourned.

ELEVENTH SESSION

LUNCHEON-THURSDAY, OCTOBER 28, 1937, 12: 30 P. M.

PRESIDENT LESER: Gentlemen, the eleventh session of this conference will be in order.

The impressive thing about our meeting this year is not only the large size of the conference, the large number of the delegates, but the evidence of interest taken in the proceedings, and I measure that interest not by the numbers that are registered, but by the numbers that participate and attend the daily sessions. I don't recall any conference—and I have been to nearly all of them in twenty-nine years—in which there has been such a demonstration of interest.

That was shown pointedly yesterday afternoon: a session devoted to the discussion of railroad taxation, which some people might consider a dry subject, and yet the room was filled and some stayed on to the bitter end.

I imagine that the enthusiasm shown at this session up to this point, which has been the enthusiastic consuming of food, reflects the interest that was aroused a year ago, which I believe was the first time that a round table was held for the discussion of this particular subject of research in tax work.

The meeting will be presided over by a gentlemen whose acquaintance I made a year ago when his boss had summoned me to Springfield, Illinois to address 300 assessors, on the hottest day that ever was known in Springfield—109 in the shade. There were huge chunks of ice on the platform with electric fans blowing the cold air into the atmosphere.

I hope you will not have such a hot time here and if you do it will be the fault of the gentleman from Springfield who will now preside and to whom I turn over the gavel, Mr. George W. Mitchell.

CHAIRMAN MITCHELL: I hope the end of this session won't be as bitter as that one yesterday. At any rate it won't be quite as far in the future as the one was yesterday because this meeting has to end at three o'clock, or slightly before, so you can rest assured that at that time you will be able to leave in peace.

Judge Leser's reference to his visit to Springfield last year reminds me that I ought to tell him this (I have withheld the information from him up to this point but it seems that this is an appropriate time to mention it): there were about 300 assessors at that meeting, and it was a little bit warm. In Illinois when it gets warm,

everyone takes off his coat; then after he gets his coat off, if he is still warm, he takes off his tie—and that was about as warm as it got that day. Judge Leser appeared in Sprinfield with a light-weight suit, but it was dark—black, in fact. We tried our best to persuade him he would be a little more comfortable if he took off his coat and slightly more comfortable if he would take off his tie, and he would feel perfectly at home. But he did not, and today if you go out into the “sticks” of Illinois and ask the assessors what they thought about the last meeting we had they will say, “I admire the fortitude of the gentleman from Maryland who kept his coat on.”

As Judge Leser has mentioned, a year ago marked the first round table session devoted to research projects, and at that round table an effort was made to sort of survey the field to find out how many tax commissions were devoting some of their energies to tax research. And while we found a considerable amount of interest in the field of tax research we found not much activity. There were some conspicuous exceptions to that, but on the whole the research programs of tax commissions were not well defined and they were not being carried forward by trained and competent personnel.

This year we want to do somewhat different at this round table. We want to present some definite programs not only of tax commission agencies but also of private agencies in the field of tax research.

I probably should sound some sort of warning to people who have a rather fine understanding of the word, “research,” in particular if they are carrying it over from the field of the physical sciences, and that is that tax research as carried on in this country is quite a bit different from research in the physical sciences.

In general, it divides itself into two groups: one—well, I don't like to use the word “propaganda” but it seems to fit in fairly well—those groups which have some special interest to serve and who employ people to do work in tax research in order to meet those ends. Now, the ends may be quite praiseworthy, and for that reason I rather hope you won't associate the word “propaganda” with any undesired ill effects, but merely note that there is a special interest there dictating the direction and the objectives of the research.

Of course, it occurs to me immediately that this group can be subdivided into those who are promoting the interests of the taxpayers and those who are promoting the interests of tax eaters, or tax administrators, whichever you prefer to call them.

The other type of research that is being carried on is something like what Henry Schultz calls the “scientific fishing expedition.” You assemble a mass of data and you try to get it in as good shape as you can, and when you have it all assembled and tabulated you start looking for something the data shows.

That may be a pretty scientific method but it is very costly and frequently leads to important results or no results at all.

We have that sort of thing going on in most of the states in the form of the general purpose tables that the states prepare as a matter of course on the operation of their tax systems. But at this round table today I think we have a fairly good representation of all the kinds of research that is going on in the country at the present time.

The first speaker is Mr. Geoffroy of the Kansas Legislative Council. On your program, Mr. Jensen's name is mentioned, but he was unable to be here and in his stead we have Mr. Geoffroy, whom I will now introduce.

JACK M. GEOFFROY: Mr. Chairman, Ladies and Gentlemen of the Round Table: So that there will be no confusion, I had better indicate that I am not of the legislative council, itself. I am a research associate in the research department of the legislative council.

I share with all of you a deep regret that Professor Jensen was unable to attend this conference. He asked me to assure you, however, that he will be here next year and to convey his good wishes to the meeting.

THE TAX RESEARCH PROGRAM OF THE KANSAS LEGISLATIVE COUNCIL

JENS P. JENSEN ¹

Professor of Economics, University of Kansas

Tax research has played an important part in the programs which the Kansas Legislative Council has prepared for the past two legislative sessions, and the council reports in this field have been responsible in no small measure for the nation-wide interest which has been focused upon this new agency. A brief description of the council may be helpful, at this point, because its character and duties determine largely the nature of the research work undertaken.

The legislative council of Kansas was created by statute in 1933.² It consists of ten senators and fifteen representatives, appointed by the president of the senate and the speaker of the house at the close of each regular session, subject to approval by a majority vote of the respective houses. These two presiding officers are *ex officio* members, and serve as chairman and vice-chairman, respectively, the revisor of statutes being *ex officio* secretary. Appointments to the council reflect the strength of the two major parties and include selection from the most important committees of both houses.

The council is strictly *legislative*, its primary purpose being to prepare a program for the next regular session. This emphasis upon the legislative character of the council is no accident. A chief aim of at least some of the promoters of the council idea was to strengthen the legislative branch of the state government. The task

¹ Prepared in collaboration with and presented by Jack M. Geoffroy, research associate, research department, Kansas Legislative Council.

² Laws of 1933, Ch. 207.

of determining public policy is now too great to be performed in the regular biennial sessions limited to two months each, unless the procedure and the work are systematized and facilitated. Principal extension of the legislature has hitherto been the special interim commission, recent examples, in Kansas, being the tax code, school code, and public welfare commissions. The council, with its research department, is in effect a permanent interim committee with a flexible and multiple assignment.

Obviously, the council, itself so constituted, is not designed or adapted to do research work. The annual appropriation of \$5,000 to the council for general purposes does not suffice to more than cover the general operating expenses of the council, including the four quarterly meetings each year. Nevertheless the work assigned to it by law, outside of the routine operations, is either research work or work that requires much research to give it any significance. Section three of the act creating the council assigns to it the following duties: to investigate possibilities (1) for consolidations in the state government, for elimination of unnecessary activities and duplication in office, and of methods of increasing efficiency and (2) of effecting economies, of reforming the system of local government with a view to simplifying the organization of government; also to cooperate with the administration in devising means of enforcing the law and improving the effectiveness of administrative methods. Without basic and pertinent research data the investigations and studies of the council of these matters would be a comedy of errors.

These required inquiries are much more specific than the blanket assignment given in section two of the same act, which makes it the duty of the council "to collect information concerning the government and general welfare of the state, examine the effects of previously enacted statutes and recommend amendments thereto, deal with important issues of public policy and questions of state-wide interest and to prepare a legislative program in the form of bills or otherwise, as in its opinion the welfare of the state may require, to be presented at the next session of the legislature."

The service agency provided to conduct the research required by these assignments is the research department of the council, organized in 1934, under the council's authority to "employ such assistants and engage the services of such research agencies as it may deem desirable, and its appropriation permits." The staff now consists of three trained research men with ample provisions for clerical assistance. Technicians and consultants are called in as required. The director is, and has been since the beginning, Dr. Frederic H. Guild, chairman of the department of political science of the University of Kansas. Much of the success of the council and of its activities has been due to the integrity of the staff in providing strictly factual and impartial material, to its capacity for getting things done and to its skill in organizing and following a procedure that minimizes clashes of interest, suspicion and jealousy.

Assignments to the department for research are made by either the council or its committees. Under the broad authorization in the law, it is difficult to imagine any question that might not at some time be affected with public interest, and so come up for investigation as a matter of public policy. The items on the calendar of the department at a given time are in fact very numerous and variegated as will be shown by a sample list of reports which are given below. At the present time, nearly a score of minor and two major projects face the research staff, with fourteen months yet to go till the next regular legislative session. It is no small task to guide the work of such a department with so many irons in the fire so that all are "heated" and none "burned".

There is nothing dictatorial in the selection of matters for investigation. While part of the questions originate with the members themselves, others are suggested by non-member legislators and by interested citizens. Some may come from the governor's messages. But because, unlike Julius Caesar, neither the council nor the research department can do everything at once, some process of selection is necessary. The council and the committees sift the suggestions and requests, separating the wheat from the chaff, eliminating the inconsequential and irrelevant, and assigning the remainder for study by the department staff. Preliminary, and, later, final reports are made to the committees or to the council. The latter ultimately reports to the legislature, presenting factual background indicating the alternatives or possibly bills embodying more specific recommendations. By law, final council reports must be made public at least 30 days before the regular legislative session following.

There are many tests of the achievements of the council—possibly one should say the achievements of the council and the research department, for it is now generally accepted in the state that neither the council nor the department could function successfully without the other. This attitude did not exist at the beginning, at least not in the minds of the generality of citizens and even of the legislators. The building up of mutual dependency and respect may yet prove to be the most significant achievement of the first few years of the council idea.

But one naturally looks for more tangible evidence, and the most obvious source of this is the list of reports presented by the research department. In the first 30 months of the combination of council and research staff, some 59 mimeographed or printed reports were presented, on more than half that number of separate projects, aggregating about 1,700 pages of material.

By a classification principle that would be serviceable to a student of taxation, we may ascertain that 27 of the 59 reports were distinctly in the field of public finance, and that, of these, twelve dealt with some phase of taxation, the remaining fifteen dealing with the state debt, budgetary procedure and requirements, possible revenue,

cost of government, and so on. This is a rather heavy emphasis on public finance projects, which may be partly explained in two ways: in the first place, some of the reports here counted are supplementary. Thus the first report, *The Sales Tax*, was followed within a year by two supplementary reports, owing to the activity in that field at that time. In the second place, the state tax commission of Kansas, for various reasons, of which absence of appropriations for that purpose is one, had done very little research, in the sense that research is now conducted by tax commissions of certain other states.

In the event of the establishment of a research division within the tax commission, we might expect that the number of taxation projects assigned to the research department would decline. Nevertheless, even had the tax commission been so equipped in the past, there would have remained a definite field for research by the council in public finance, especially research upon matters of primarily legislative interest. The fact is that the council has relied, and would continue to rely, upon its own staff to select from the factual material available that which would prove of immediate, definite legislative value for the coming session. In addition, the regular reporting to the quarterly meetings of the council usually permits analysis and state-wide consideration of proposals long before any strong, definite movement has developed for a specific solution. In many cases the preliminary research report presents facts which entirely change the trend of popular discussion.

It is interesting to note that an attempt in the 1937 session of the legislature to create another tax code commission, as a special interim commission, failed; and that, instead, the legislative council directed the research department to conduct a survey in taxation, which is well under way now, and will probably result in a number of separate reports. Such an arrangement seemingly tends to prove the acceptance by the legislature of the council's research. This survey in taxation forms one of the two major projects now in progress; the other is on state governmental reorganization. These two offer a good case for the advantages of a central research agency, as compared with separate interim commissions for each project. The field of tax administration would have to be covered by both, with inevitable waste efforts and cost.

One phase of the tax program of the council has involved extensive estimates of revenue, particularly of new sources of revenue. The report on "Potential Sources of Additional Revenue from Taxation", prepared by the research department in advance of the 1937 session, contained detailed information and estimates of revenue yield from twenty sources. This session was faced with the major problem of securing considerable additional revenue to finance social security and school aid, and to grant certain ad valorem tax relief. In consequence, the report was used extensively in discussion in committees and on the floor of both houses. Actual collections for

1937 under the income tax law, and under the new sales tax, beer tax, and unemployment compensation laws have demonstrated these estimates to be highly reliable.

Some of the taxation projects reported on, other than those mentioned, include income tax rates and exemptions, corporation fees, cost of government in Kansas, homestead tax exemption, gasoline tax exemptions in Kansas, and others. Under the survey now in progress presumably all phases of taxation will be studied and reported upon.

The catholicity of the projects other than public finance is noticeable from a partial list of the reports prepared. State police, mortgage moratorium problem, the loan shark problem, school text book adoption in Kansas, state aid to municipal subdivisions, soil drifting, community sales, safety regulations for motor vehicles, field bindweed in Kansas, are among the reported projects. Besides these, three major projects, namely a survey of the state's penal and charitable institutions; a study of the various phases of the social security program; and an analysis of the problem of equalizing school costs, have each been the subject of several separate reports. Directly or indirectly, most of these involved questions of taxation.

Obviously, much of the data compiled by the research department is never included in published reports, owing in part to the varied and shifting interest of members of the council, but more to the fact that the reports are condensed as a matter of definite policy. All collateral information, and material prepared for committees without formal report, is available in the files and is used by council members, other legislators, state officials, and to a limited extent by the general public.

In one respect the reports are disappointing to a minority, including myself. There is little of the fine craftsmanship, evidenced by the well rounded field of inquiry and the leisurely finished preparation, which one occasionally meets in a doctoral dissertation. The reason is plain: the research reports of the council are not works of art as much as they are carriers of information called for when needed and obtained and presented under pressure. However, the reports have been deliberately adapted in form to be particularly acceptable to, and immediately usable, by the legislators. As a result, at the present time the idea of the council and its research agency is already well sold to both the legislature and the public of the state.

It is a matter of interest, finally, that while the demonstration of the utility of the council's research program may now be regarded as completed, it has not been costly, except in terms of nervous strain on the part of the research staff. A private foundation made available in 1934 the necessary funds to finance the research department. This amounted to \$15,000 for each of the first two years, and \$20,000 for the third year. For the biennium ending June 30, 1939,

the parsimonious Kansas legislature appropriated \$20,000 annually, which is a most substantial demonstration that it did approve the work of and the idea behind the research department.

CHAIRMAN MITCHELL: The next speaker represents the United States Chamber of Commerce, a much maligned, in some quarters, organization, probably at the present time a rather impotent organization, but it is difficult to tell how long that situation will endure. This gentleman, however, is all right. It gives me pleasure to present Mr. Welles A. Gray.

WELLES A. GRAY: Judge Leser, Mr. Chairman, Ladies and Gentlemen: I don't know just what to say in response to that rather lefthanded compliment, that was addressed to me as representing the United States Chamber of Commerce, but I do believe that "impotent" is hardly the word that has characterized us over a period of time. Sometimes we might be called quiescent. At other times, however, we are somewhat more vociferous even if the results achieved are not always apparent. Let me put it this way with regard to our potency, or otherwise: perhaps it is a question of not whether but when the proposals of the United States Chamber of Commerce are translated into action.

Of course, we speak for another type of organization than the one just described to you. The chamber is one of those many groups that represent the average citizen, the people who have to pay the taxes which are adopted by legislators, where, on the other hand, the other group represents the legislators and other officials and others who are drafting and adopting tax laws.

As far as the tax research of the chamber of commerce is concerned, let me refer to a chamber of commerce in upstate New York which several years ago decided that the taxes in their town were altogether too high and something ought to be done about them. So they appointed a committee to engage in a research program. This committee met one day, finished its report, handed it to the full meeting of the local chamber the next day, and their report was as follows: "We recommend that taxes in this city be reduced 30 per cent: 10 per cent for efficiency, 10 per cent for economy, and 10 per cent on general principles."

I hope that the type of research I am going to describe is a little different. In fact, I hope it is diametrically opposite to anything typified by that incident.

TAX RESEARCH PROGRAM OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA

WELLES A. GRAY

Finance Department,
Chamber of Commerce of the United States of America

The primary purpose of the chamber of commerce of the United States is to ascertain and reflect the views of business men on questions of public policy, mainly in the economic field.

Since its membership consists of about 1600 trade associations and chambers of commerce and a good many thousand individual business men and corporations, it has an obvious secondary function in the furnishing of information to members on a wide variety of subjects.

In the policy field the chamber's activity has two principal aspects, first, appraisal of the views of business men, as expressed through chambers of commerce and trade associations in all parts of the country, with the object of developing organization policies on public questions, and second, presentations to governmental agencies and others with the object of effectuating the policies which business men advocate. It follows obviously that the chamber must function in the public relations, or promotional, field, with the object of mustering general public opinion behind proposals which business men believe to be in the general public interest.

Usually the first step in this determination of what business men think on a particular public question is a committee study, following which a set of propositions may be put forward for consideration by the chamber's member organizations. These organizations, in turn, set up policies proposed by committee by voting upon them at the chamber's annual meetings or in referenda.

The executive establishment of the chamber then has a job of effectuating such policies, in which use is made of committee reports and of other materials developed in the course of research carried on for the initial committee studies of these questions.

In the public finance field the chamber's research work is mainly in connection with the activities of two committees, on federal finance, and on state and local taxation and expenditures, assisted by the staff of the chamber's finance department. There are, however, other tax research activities carried on from time to time by other departments or committees of the chamber, as for example on social security, and on unemployment relief.

The chamber does not engage in publishing voluminous reports on investigations of tax and public expenditure problems. As indicated, its research is directed primarily to policy development and effectuation.

Business men are impatient with long reports and dissertations giving elaborate pros and cons. Therefore much of the research which we do is designed primarily to facilitate examination by our

committees of important questions and in the event that a committee decides not to proceed with development of a particular policy, nothing may be published on it by the chamber, although an exhaustive study may have been made. When our committee reports and other published documents finally appear they usually are brief, condensed statements, in view of the audience to which they are designed to appeal, and in many instances are scarcely indicative of the nature and amount of research and study which went into their preparation.

The interest of the national chamber in problems of taxation and public finance dates from the beginning of its organization in 1912. Time does not permit a historical review of the chamber's activities in public finance, but I would remark parenthetically that the chamber's first referendum dealt with the question of the establishment of a federal budget system, and various publications involving research on this matter were issued. Continuously since that time the chamber has been actively interested in public fiscal questions.

The chamber considers it highly improper to intrude itself into fiscal questions at issue in any particular state or community. Thus its work in the state and local finance field has been directed mainly to encouraging activity by its member organizations upon the fiscal problems of their own states and communities, and to developing materials designed to assist these organizations in their work, by placing before them information with respect to currently accepted principles and practices on various aspects of state and local finance.

Capital outlay, budget methods and budget control, tax collection methods and assessments are a few of the subjects in this field which have been given careful study. The latest report of our state and local tax committee, issued last June, is an appraisal of various methods of local debt control with recommendations as to procedures which appear most effective.

One project immediately before our committee is the development of suggestions for improving and increasing the availability of statistical material on state and local fiscal operations, particularly the operations of local governments. It is hoped to encourage gathering and publication by the states of essential data on local taxes and expenditures. Some few states now issue adequate and satisfactory material. Little or nothing, however, is compiled and published by the great majority of the states and it is the desire of our committee to develop, first, a program of minimum essentials for such statistics and, second, a *modus operandi* for developing such state-published materials on a national scale.

As a number of you already know, the census bureau recently has taken steps for general revision and improvement of its publications on financial statistics of states and cities. Some assistance has been given by the chamber to a special advisory committee appointed by the secretary of commerce for this purpose. There are good indications that extensive revision and improvement of these statistics will be made at an early date.

Another current project of the chamber's committee on state and local taxation and expenditures deals with long-term financial planning by local governments. Prior to the depression much was said about the desirability of such planning. Our committee is seeking to develop information as to how such long-term programs stood up under the impact of the depression and what lessons, if any—can be learned from the experience of the last decade. Such a project, of course, is of particular importance to chambers of commerce in view of the traditional association of local commercial organizations with municipal construction projects.

Other matters in the state and local field now engaging the attention of our committee include gross income and gross receipts taxes, and simplification of tax reporting by business.

Although not a project of the national chamber as such, it may be pertinent here to mention a study now under way by the chamber of commerce secretaries' professional organization, the National Association of Commercial Organization Secretaries, inasmuch as we are cooperating with the association in making it. This study is an attempt to appraise current trends growing out of the new financial relations between federal, state and local governments which developed during the depression and which have been accompanied by a centralization of control over the affairs of governments benefiting from the newer financial aids.

In the federal finance field the chamber's objective may be stated as the development of a fiscal system which business men can advocate as being in the public interest. Revenue policy cannot be separated from other questions of fiscal policy such as the level of expenditures, budgetary and legislative procedure, treatment of the national debt, and surplus and deficit financing. Thus over the years the chamber has dealt with these and many other questions pertaining to the government's fiscal policy, although a description of many of these studies would hardly be pertinent to this discussion of the chamber's tax research.

With respect to revenue questions, such matters as the adequacy of the revenues, inequitable provisions of various tax measures, good administration of the tax laws, and the effects of particular taxes upon the general economic welfare are given consideration.

The major interest of our committee on federal finance today is, of course, the new revenue act in prospect this winter. In the absence of specific official proposals, present studies must embrace practically the whole field of revenue policy, involving numerous questions of corporate and individual income taxes, estate taxes, excises, and matters of tax administration. Examination is being made of the defects in the present revenue laws with a view to obtaining modifications in the public interest.

Preeminent among existing defects in our tax laws are provisions of the surtax on undistributed corporate earnings. With the co-

operation of trade associations and state and local chambers of commerce, data were gathered during the summer and early fall showing the economic effects of this tax as illustrated by concrete experiences. Based upon these data a memorandum was prepared showing in detail the inequitable applications of this tax, and turned over to federal officials as well as distributed to chamber members. Incidentally, research since the passage of this law has fully supported the objections made by the chamber to this tax as a result of very extensive studies when the idea of such a tax was proposed in 1936.

Of first importance are the effects of any application of the principle of a tax to compel distribution of corporate earnings—the effects upon government revenues as well as upon the general economic situation. Exposition of this subject presumably will be made by the chamber's committee. Substitute propositions necessarily must be examined. Such a feature of the revenue law cannot be dealt with satisfactorily without consideration of its general relationship to other provisions of tax laws, not only federal but also state and local.

Capital gains and losses are another major aspect of federal tax legislation to which the chamber is giving special study. Here again there are studies of the principles involved and the effects of the existing tax as well as of possible modifications. Other matters now engaging our attention include the general level of income tax rates, the question of carrying forward losses, and the capital stock and excess profits taxes, to mention only a few. When proposals of the administration or of the revenue committees of the congress are evolved study will be made to determine their advisability.

There gradually has been accumulating in the files of the chamber a mass of data of continuous value in connection with studies of new proposals and the identification of hardships and inequities. Some of this material has to do with economic trends, but much of it is upon government fiscal matters.

It must be apparent, from what I have said, that the principal research problem of the chamber in connection with federal legislation is one of wise selection of questions to be dealt with. At no time in the history of our federal revenue legislation has there ever been a comprehensive official or legislative inquiry, with adequate time and research, aimed to develop basic policies which might be regarded as permanent guides. There have been five new revenue measures in the past six years, most of them opportunistic and of a patchwork nature. Therefore, the chamber in its tax research program, like many other agencies, must deal mainly with what is placed before the congress either by the administration or by congressional committees.

Working with the American section of the International Chamber of Commerce, the national chamber also has been active in the field of international double taxation. Without attempting to go into

detail with respect to our various activities in this field, it might be mentioned that there has been cooperation through the international chamber, in connection with various draft conventions which seek to minimize or avoid injurious double taxation of an international nature. In this field there have been studies here and abroad of means of eliminating international double taxation by unilateral action and by the adoption of reciprocal statutes of exemption, as well as through bilateral or multilateral treaties. One notable success here is the wide adoption of reciprocal treatment of earnings of shipping companies. A notable study now under way deals with the problem of proper allocation between nations of the income from business enterprises.

In conclusion, a word as to the value of committee studies in conjunction with a tax research program: our committees at the national chamber are made up not only of business executives but of tax experts, attorneys and economists, and also of others with experience as official administrators. On many occasions in the past as well as at present we have had serving on these committees men who have been prominent in the affairs of the National Tax Association, including several former presidents. In view of the many imponderable factors which are involved in any determination of public fiscal policy a sifting of opinion among such groups whose members combine theory with years of practical experience can be very important from the standpoint of sound policy, and sometimes outweigh in value the results of purely technical tax research.

CHAIRMAN MITCHELL: Delaware is a small state and probably if the DuPonts moved out a good many of us would forget that there was such a state, but whenever anyone wants to know anything about Delaware they say, "Ask Daugherty." It is the one state in the country that has a one-man research department. It gives me pleasure to introduce Mr. Daugherty.

M. M. DAUGHERTY (Delaware): This seems to be a session of left-handed compliments.

Your chairman has bidden me to be brief and, by implication, to be witty. I shall at least be brief.

One of these things (referred to the microphone) always terrifies me and if you see my hand shake you will know it is on account of it.

I think what this country needs, in addition to a good five-cent cigar, is two devices: one of them a way for controlling professors who grade papers, a mechanical device. This business of taking the papers and throwing them up on a flight of stairs and giving those that land highest A, the next highest B, and flunking the last quarter is all wrong.

Another thing we need is a device to put on the radio that will automatically cut it off the minute anyone begins to speak.

If we had those things I think we would be very much better off.

The president of the association said you people had been very kind in staying at the meeting yesterday afternoon to the bitter end. I suppose he knows that I was the man who spoke last on that program.

THE TAX RESEARCH PROGRAM IN DELAWARE

M. M. DAUGHERTY

Agricultural Economist,
Agricultural Experiment Station,
University of Delaware

Our taxation research in Delaware was started ten years ago by the agricultural experiment station of the University of Delaware. The original thought was that it would be confined to ascertaining the farmer's contribution to the public purse and his direct benefits from the public purse. Accordingly the first study made was entitled "The Assessment and Equalization of Real Property," the next "Highway Finance," the next "Financing Education," and the next "Receipts and Expenditures of County Government." We are now engaged in an analysis of the sources of receipts of the state's revenues, and a functional analysis of its disposal. This study is for the purpose of presenting a summary exposition of Delaware's finances for use by those charged with the administration of the state's affairs.

In all of our studies we present the facts over a sufficiently long time to give the reader an historical perspective. When making the first studies it was necessary to look up the history of the support and administration of these functions. In making this last study we found that it was necessary to know the whole financial history of the state, even though it had never been written. We are now preparing a financial history of the state, and we find that it explains many heretofore puzzling things in the present-day financial system and practice. For instance, it explains why Delaware now taxes the railroads on a flat annual rate rather than on a value basis. It also throws light on using lotteries as means of raising revenue and on numerous other questions of current interest. Delaware has a financial history 300 years old, and the more one studies it the more one is convinced that there is nothing new under the sun.

In 1800 the state government spent \$13,600 for all governmental purposes. In 1850 it spent \$27,000, and in 1900 it spent \$500,000, in 1920 \$4,150,000, and in 1936, \$12,100,000. We are accustomed to associate a rise in governmental expenditure with either wars or depressions. But this increase is for peace-time activities and activities having nothing to do with depressions. A knowledge of these increases leads one to ask what are the limits to the expenditures of public funds. Of course it is easy to say that we demand more of our governments than we formerly did, that we are able to

pay for more governmental services now than formerly, but those answers do not solve the question of where we are going in governmental expenditures, nor how far we should go.

The tremendous increases in expenditures differ in degree only from those of the other states of the union, and to a lesser degree, other governmental units. All the states have increased their expenditures, but this increase prompts the question of the location of the limits of expenditure of public funds.

I think the most important phase of our program in Delaware is the examination of the expenditures of the public funds. By the examination of the expenditure of public funds I do not mean that we inquire into the efficiency of particular portions of that expenditure, but rather into the whole idea of that kind of an expenditure, and the economic limits to which it can profitably be carried.

An example of this kind of analysis is in the analysis of the expenditure for public education. That there are limits to the expenditure for this important function we must all agree, for we cannot all go to school all our lives. Indeed there has been three different concepts of the justification of public participation in educational activities in the three hundred years of Delaware's history. For the first hundred years it was justified by the public desire to bring up the young in the faith of their fathers, a religious theory of education. The next hundred years it was justified by the desire to produce the highest type of political leaders and intelligent followers, a political theory of education. From about 1875 to date it has been justified by the thought that education increased economic productivity, an economic productivity theory of education. Since it is now justified on an economic productivity theory, it can be judged by an economic yardstick.

To bring to bear the proper principles of economics on the problem of public participation in education, and the limits to which public education can be pushed, is a type of research upon which we have concentrated. We do not think that these economic theories of the expenditures of public funds are going to cause any immediate facing about of governmental policies, but we do believe that in the future they will prove valuable. It is our hope to be able to study all the expenditures of the state by functions and to lay the groundwork for a theory of economic expenditures of public funds.

There is another phase of our research work which I believe you will agree is important. The state income tax law requires that everyone shall file an income tax return, whether or not he has any income. In this, Delaware is unique. In cooperation with the state tax department and the National Bureau of Economic Research we are making a study of the incomes of the lower income groups of the state. The reason for this study is that there are practically no data available anywhere else in regard to the lower income group. Those making estimates of the national income are very much handicapped

by the lack of factual matter in regard to the incomes. We are assisting in this study because we believe that it will add to the available knowledge of the national income.

PRESIDENT LESER: Hearing what Mr. Daugherty has said reminds me of the simple system they have in Delaware for building highways. They simply have Mr. duPont do it. Also the simple system they have for taxing railroads. They simply compute how much is raised from other sources and whatever else they need it is put in the form of a flat payment by the railroads.

Mr. Daugherty has said that they have received 80,000 returns. He also said that their law requires everybody to make a return. It is the first time I ever heard that Delaware's population was 80,000.

He also said that they live in glass houses. Anybody would agree with that if he had been at Longwood, also owned by duPont, where they have I think four acres under glass—the most notable collection of plants in the whole United States.

Finally, he also said that people in Delaware, including himself, get educated somewhere. In my household the word "educated" is forbidden. Whenever my wife says, "I was educated at Mount De Salles," I say, "Let somebody else say you were educated. You may say, 'I went there.'"

CHAIRMAN MITCHELL: I see by my watch that we have forty minutes remaining and there are three people left to speak. They can take those forty minutes and divide them up by any number they wish, from one to three, but they will have to get through in forty minutes, so I am going to take hold of this thing and crack down on the first speaker up unless I hear something to the contrary.

Here comes a WPA representative. Here again, I don't want any of you to let your prejudices interfere with your careful attention to what he has to say, because he is all right. I present Paul F. Krueger.

PAUL F. KRUEGER: I don't know where the butcher knife is but, instead of dividing those forty minutes by any number from one to three maybe I had better divide it by ten and be safe.

I had been under the impression that the word "project" was a byword of the emergency relief program, but since it is already in the vocabulary of the chamber of commerce, I don't know but what that makes us, really, brothers under the skin or something like that.

Dr. Rice of the central statistical board, speaking of the extent to which research has been carried on under the Works Progress Administration program, refers to the fact that every year the WPA spends as much on its research program in the form of administrative research conducted by the Washington office of the WPA and the research program conducted under individual WPA projects as

the three largest statistical agencies of the federal government spend in one year. That is, the WPA expenditures amount to as much as the regular budgets of these three largest statistical agencies.

THE TAX RESEARCH PROGRAM OF THE WORKS PROGRESS ADMINISTRATION

PAUL F. KRUEGER

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The Works Progress Administration has operated projects dealing with practically every phase of the field of taxation and public finance. While a considerable portion of these projects have been purely research in nature, a great number have been concerned with simply the improvement and modernization of tax records. Most of the latter, although immediately concerned with records from an administrative point of view, are equally important from the research point of view.

Projects in this general field have varied widely, both as to subject matter and geographic area of coverage. In a number of states there have been conducted statewide projects in the field of research in government finance. These projects have collected and analyzed data on receipts and expenditures for every political subdivision of the state—counties, townships, municipalities, school districts, and all other special purpose districts. The principal objective of such projects has been to determine the amount of funds which have been collected and expended by governmental units and to analyze the sources of revenue, purpose of disbursement, and method of collection and expenditure. The most comprehensive project in this field is the one being conducted by the Illinois Tax Commission, about which Dr. Leland will speak later in this round table. In most instances of such statewide projects the state tax commission has acted as project sponsor. In a few cases, however, bodies such as the association of county commissioners and the state university have sponsored projects. In addition to these, projects similar in nature have been conducted by counties, townships or municipalities.

Another type of project which has been operated statewide has been the study of the effect of proposed homestead exemption laws. In several states legislatures have had under consideration proposals to exempt homesteads from taxation or to impose certain limitations upon the taxation of homesteads. In order that facts may be made available, on the basis of which such proposed legislation may be intelligently considered, the WPA has assisted in the collection and analysis of data showing the effects of exemption or limitation upon the availability of revenue for various purposes under different definitions of a homestead and different methods of application of the law.

With the tremendous increase in tax delinquency attendant to the depression and the increased pressure for the collection of delinquent taxes in the last few years, tax administrators have found that if they are to approach their problem intelligently a great deal of information must be made available to them. With the assistance of WPA they have collected and analyzed data to show the years of greatest delinquency, extent of delinquency by class of property uses, by type of owner, type of soil, improved or unimproved, assessed valuation, and geographic location. State tax commissions and equalization boards have extended this type of study to include the efficacy and uniformity of tax administration. Studies of assessment ratios point to the necessity for standardization of assessment practice and the prescription of certain rules and regulations governing procedure. Thorough analysis of both technical and administrative aspects has revealed weak points and has indicated where revisions should be effected.

The WPA has also been of assistance in another type of project closely related to the above, that is, in the collection and analysis of data on properties which have been forfeited to the state, county or municipality for delinquent taxes. In the past it has been the general practice to endeavor to dispose of forfeited properties in order to place them back on the tax-paying rolls. Little consideration was given to the factors which contributed to delinquency, to the tax burden which forfeited properties were expected to bear, or to their ability to bear this burden. In many localities the extent of forfeitures had been so great and the records so meager that public officials did not even know what properties had been foreclosed. Numerous instances have been discovered in which the previous owner continued to use the property, although paying no taxes. In one case, a vacant lot in the downtown area of a fairly large city had been taken over by the city, although it continued in private use as a parking lot and produced considerable income, tax free. A number of projects have been conducted with the objective, first, of preparing an adequate record, and second, analyzing all available data on these foreclosed properties. Tax authorities have cooperated with land use planning officials in carrying out this program so that after thorough analysis those properties which can be used in the public land program for parks, recreation areas, forests, etc., are retained, while only those adapted for profitable utilization under private ownership are disposed of.

One other research project in the field of taxation should be mentioned. The WPA is assisting in the comprehensive analysis of the income tax returns in the state of Wisconsin for the years 1929-36. The study includes analysis along the following lines: number of returns classified by income bracket showing total income, net taxable income, source or composition of income, deductions claimed, marital status of individuals filing returns and number of dependents, joint returns and distribution by geographic location.

In addition to these types of research projects, there has been a great demand for the improvement of tax records to facilitate tax administration. Although the assessment manuals prepared by most tax commissions recognize the value and urge the use of tax maps, probably 50% of the assessment districts in the country either do not have maps at all or have maps which are hopelessly out of date and are, therefore, of practically no value. Four states are conducting statewide projects involving the compilation of tax maps or plat books. In the other states a great number of counties, townships and municipalities are operating projects for this purpose. I consider projects of this nature of basic importance in the maintenance of an adequate set of records pertaining to real estate. A good map showing the location of every parcel of property is of use not only to the assessor, but to the agencies in the field of land use planning. In many instances these agencies have had to compile their own maps because the assessor did not have any.

In the past two or three years there has been a great increase in the attention given to the appraisal of real estate for tax assessment purposes. Although a part of this interest has been due to the necessity for the assessor to justify an increase in assessed valuation attendant to the general increase in real estate prices, it has been partly due to a genuine interest of assessing officials in improving their assessment practices. Nearly 100 counties, townships and municipalities have operated projects contemplating the installation of a scientific procedure for the appraisal of real estate for tax assessment purposes.

Public officials responsible for the collection of taxes have also shown a great interest in the improvement of their record systems. In most localities a separate delinquent tax roll for each year is usually prepared. With the great increase in tax delinquency attendant to the depression and the increased pressure for the collection of delinquent taxes in the last few years, the tax collector has found that it takes a great deal of time to search back through the rolls for several years to determine the total delinquency for an individual property owner. WPA funds, therefore, have been requested to compile a cumulative statement for each delinquent tax payer and to install a card or loose-leaf ledger record system in which a separate account will be maintained for each parcel of property. This record, to be maintained by the tax collector, is designed to take the place of the old annual roll.

As we examine more closely the experience which we have gained and the difficulties which have been encountered in carrying out this program, we note several points of peculiar significance. The chaotic state, the inadequacy and the lack of uniformity in public records pertaining to revenues and expenditures is at least impressive. In many localities where studies of government finance have been carried out, the task of simply compiling data on the amount of

funds received and disbursed has been tremendous. It has been even more difficult to determine the source of revenue or the purpose of expenditure, to say nothing of the problem of compiling and analyzing these data on the basis of comparability between one locality and another. In most instances the anticipated cost of conducting studies of this type was originally underestimated because it was not realized what work would be necessary in finding the records and putting them in shape before the study could actually be started.

To a very great degree, therefore, it has been found that the first interest of any research group must be in the improvement of sources of data. Although the primary purpose of most public records is an administrative one, too many public officials have been content to follow previous practice in keeping or not keeping their records. To what extent the present interest in the improvement of records is due to pressure from research groups it would be difficult to say. It can be said very definitely, however, that public administrators, through their recognition of the value of research and the necessity of having full and complete information on problems at hand before questions of policy can be intelligently solved, have proved to themselves that adequate records are necessary. I may cite as an example the case of the tax collector in one of our large cities who desired to make a thorough analysis of his tax delinquency situation. This necessitated a very thorough examination of the delinquent tax rolls for at least the past ten years and the compilation of a cumulative figure for each property. It was only in recognizing the value of such an analysis that he also recognized that the opportunity should be taken to install a sound record system. With the prevalence of deferred payments and charge accounts a department store, for instance, if it maintains the same type of accounts as are in use in most tax collectors' offices today, would have the same difficult task making collections. It is equally important and necessary in the routine conduct of an office as for research that records be kept in such a manner that information is easily available.

There exists another serious deficiency in the record of descriptive information pertaining to real estate. Although investments in real property represent the largest single item in the assets of present day communities, and although assessors periodically fix a valuation figure for real estate, there is very little which is a matter of record of its physical characteristics. The more progressive assessors have adopted scientific appraisal techniques and have accumulated accurate records, but unfortunately they are in the minority. With the increase in the interest in housing in the last few years it has been necessary to spend millions of dollars collecting information on the physical condition of residences. If our assessors had only had this information available for their own use, it could have been used for other purposes as well without the expenditure of additional funds.

Unfortunately, even where good records are kept, they have not always been used to the fullest extent due to interdepartmental jealousy and the lack of cooperation between departments. Illustrative of this I may refer to the case in which the housing, zoning and planning authorities in one of our larger cities desired to conduct a land use study. Although practically all of the data necessary for this study could be found in the files in the assessor's office, the assessor himself was unwilling to make the information available to other departments because he was afraid that errors would be found which would reflect upon the efficiency and prestige of his own department. The lack of cooperation between departments results sometimes in a great deal of confusion. It very often happens, for instance, that the assessor, the recorder, the engineer or surveyor, and the water department, as well as other departments, use different systems of identification of properties. When these departments use entirely different bases for their identification, such as name of owner, street address and block and lot number, the principal objection is only lack of comparability, but numerous instances have been found in which several different systems of block and lot numbers are used by the various offices. The result here is not only lack of comparability of data from the various departments, but confusion of both the citizens and the officials.

In the operation of WPA projects a number of difficulties have been encountered other than those referred to above pertaining to the state of the records. In many instances, although project sponsors have a genuine desire to perform their functions creditably, they lack the time necessary to take an active part in the supervision of the work to be done or are not sufficiently competent and experienced to supervise the work. In all too many cases they think in terms of past practices and do not realize that an unsound or inadequate record well kept is only slightly better than the same record poorly kept. Yet in the absence of standards recommended by recognized authorities in their field and without sufficient experience to think through their own problems, they are quite at a loss to know how they can improve their record systems and office procedures.

It is well recognized that there are certain responsibilities which sponsors of WPA projects must assume in the way of interpretation and utilization of results achieved from their projects. A comprehensive analysis of tax delinquency, for instance, may indicate that certain revisions in the tax structure or administration are necessary. It is the sole responsibility of the sponsor to interpret the data which may have been compiled and then to actually carry through any steps which this interpretation may indicate. Furthermore, if the project has been one of the type in which certain new records have been established, it is the responsibility of the sponsor to currently maintain those records.

After over two years' experience with the WPA program in the field of public finance it is extremely interesting and heartening to note the increase in the genuine interest on the part of public officials in the improvement of their procedures and practices. I believe that recognition of the importance of the role of research in the field of taxation as indicated by the initiation of this round table at the Indianapolis conference of the National Tax Association last year and as continued at the present conference is only indicative of the recognition of its importance in the general field of public administration. In the conduct of the WPA program we are endeavoring to adhere to the standards established by this and other professional associations and by the recognized authorities in the field. We believe that in this endeavor we are making some immediate research contribution. We also believe, and this is equally important, that by assisting in the installation of sound and adequate record systems we are making some contribution toward efficient public administration and at the same time facilitating future research.

CHAIRMAN MITCHELL: You lost about a minute there, Paul, so it will be up to the other boys to make it up.

At a time like this I suppose I have an excellent opportunity to ingratiate myself with my boss or else get even with him. I am, however, going to resist the temptation to do either and say that here is a chance to hear about one of those scientific fishing expeditions. I present Mr. Leland!

SIMEON E. LELAND (Illinois): The boys all know I am no fisherman. My experience this summer proved I couldn't fish. I am really here, though, in the role of a stuffed shirt like most of the tax commissioners who come to these meetings and who leave behind them the men who really do the work, with this essential difference: that while I have had the nominal supervision and the sponsorship of this project and have signed the thirteen and one pink, red, yellow, blue, green, and other slips which the WPA requires, the direct supervision of this work has been under the guidance of my lieutenant, your chairman here, Mr. Mitchell. Whatever that study really accomplishes he deserves the credit for and the blame belongs to me.

Moreover, I want to say that most of what I have been able to accomplish on the tax commission in these six years I have been on it has been due to the friendly and active cooperation of this man. The bulk of what we have been able to accomplish he has had a hand in and contributed actively to, and it is a pleasure to acknowledge my debt as well as my gratitude to him.

ILLINOIS LOCAL FINANCE SURVEY

SIMEON E. LELAND,

Chairman, Illinois Tax Commission

For the past two years the Illinois Tax Commission has been engaged in a study of the finances of local governments in the state. Almost the entire resources of the research department of the commission have been absorbed in this study, and to date approximately one hundred thousand dollars for salaries, travel expense, materials and supplies has been spent on the undertaking. This amount the commission has contributed, while the federal government, through the Works Progress Administration, has expended approximately seven hundred thousand dollars primarily for labor.¹ At the present time there are some six hundred fifty workers in the field and one hundred in the central office. The project is one of the largest locally-sponsored undertakings that has operated in the research field under the W.P.A. It is also distinguished by the relatively large demands it makes on the ability and training of the personnel. In some quarters serious question has been raised as to the advisability of undertaking with relief help a project of this size and character. It is believed, however, that the results will demonstrate that this has been a successful application of relief workers to a research project.

There are, in my opinion, at least two realizable objectives of this project which make it worth the cost to the state and federal government. These are entirely apart from the employment and training it gives to unemployed persons.²

The first arises from the rather uncommon position in which Illinois finds itself with regard to information concerning the finances

¹ An unspent balance of three hundred seventy-five thousand dollars in federal funds has been allocated to the projects.

² The knowledge gained by the workers in the financial affairs of their local governments and in the property tax procedures is an important by-product of the project. Our instructions to workers have been prepared in such a way as to furnish not only a standardized procedure for carrying on the work, but also to educate personnel in the objectives and the *raison d'être* of the work itself. Furthermore, a constant contact with the records and financial documents has led to a thorough understanding on the part of large numbers of the staff of governmental matters which ordinarily remain a complete mystery to most of the local citizenry. While this knowledge and training has necessarily been confined to a relatively limited number of people, due to the turnover of the personnel on the project no less than twelve hundred persons have at least had an opportunity of familiarizing themselves with various financial aspects of their governments. Furthermore, some benefit has accrued to local governments who employ help on tax records. Training on the survey has fitted many of our personnel for permanent jobs in local offices. While we have made no particular attempt to ascertain the number of persons who have received part- or full-time employment on county records as a result of their experience on this project, many such instances have been brought to our attention.

of its local governments. Most of the states by this time have reasonably adequate reporting to a central agency of the essential facts regarding the property tax and other sources of local revenue. The majority of them compile expenditure statistics of local governments. In Illinois, however, virtually all of this information is lacking except in the years when the federal government prepares its decennial "Census of Financial Statistics of State and Local Governments". Apart from property tax assessments reported by the tax commission, the receipts and expenditures of school districts reported by the state superintendent of public instruction, and some summary information on tax extensions available from the "State Auditor's Report", virtually no material dealing either with the property tax or any other aspect of local finance is regularly compiled and made available. Students of the tax problem in Illinois have been practically estopped in their efforts to get at these significant facts. This situation the local finance survey will remedy, at least for the decade of 1925 to 1935, and it is my hope that the presentation of this material for such a period will lead to some provision in the future for the regular compilation and publication of similar material. Indeed, in 1937 the legislature took a short step in this direction.

The second objective of the survey is to place in the hands of our research staff and other trained investigators interested in the Illinois situation a considerable fund of detailed and complete information on the property tax and the financial records of our local governments. These materials will be edited and compiled in such a way as to make them available for a great variety of purposes. The students of assessment procedure may study the results and cost of township assessment in the state: the activity and the effects of the county board of review policies. The students of township government will find verbatim copies of original township records indicating precisely the form in which the town auditors have approved and accepted the books of their local government. Those interested in analyzing tax burdens through effective tax rates and real estate delinquency will find complete and minutely classified data dealing with these problems. Persons interested in consolidating local governments will obtain data from the survey maps showing the boundaries of every local government in the state of Illinois, of which there happen to be fifteen thousand fifty-five³ as of January 1, 1937. All financial

³ *Type of District*

Number of Units

State	1
County	102
Township	1,438
Road District	181
Municipality	1,128
Common and Combination Schools	11,455
High School	559
Non-High	101

source material for this period which will shed light on any aspect of local government finance has been assembled in as much detail and completeness as is practicable; it should provide a fund of information that may be drawn upon for several years to come.

A brief summary of the scope of the project will indicate its completeness. Inasmuch as the property tax is the major and in many instances the sole source of revenue for local governments in Illinois, major attention has been devoted to this subject. Assessed valuations on the principal classes of all property (urban real estate, rural real estate, personalty, and railroad) have been obtained for each of the state's taxing districts for the period of 1925 to 1936. Complementary information on real estate assessment ratios affords a sound basis for comparing levels of assessment and the relative effectiveness of the assessment procedure. Detailed schedules showing the activities of the county boards of review in equalizing assessments within the townships, making blanket reductions, acting on individual complaints and correcting assessments on its own motion focuses attention on this important phase of the assessment process. In one year a frequency distribution has been made to show for the various classes of property the size and number of assessments in a wide range of value classes. These data together with that annually assembled by the tax commission, provide an excellent basis for study and analysis of the property tax base. Coming at the property tax from the other side are verbatim copies of tax levies made by all of the local governments in Illinois for the entire period, and accompanying these are the tax rates. At this point a very enlightening and comprehensive study could be made of the operation of tax rate limits in Illinois. During this period an elaborate system of tax rate limitation was in effect. Almost every type of rate limitation existed excepting the "overall". Even it was on the statute books as the obsolete "Juul Law", which had been practically emasculated by 1925.

The study then logically moves to the consideration of taxes extended and placed in collection. Here the extension techniques used in the various counties of the state are vividly illustrated by the assembled material. To one interested in studying the bookkeeping costs in connection with the property tax, there is much here that is of value. Finally, the survey is concerned with the collection of property taxes; for all of the counties excepting Cook a very detailed and completed analysis of the time and condition of tax payments is made. During the interval covered, Illinois has experienced a dis-

Special District	90
(Parks, Sanitary, Mosquito Abatement, Forest Preserve, Public Health, Fire Protection, River Conservancy)	
Total	15,055

count plan; a change from the single to a double installment payment, tinkering with the time of tax payment; and legislation providing for the abatement of the tax penalties. During the 1930's there has also been some use made of a statutory method for liquidating tax obligations on real estate where such obligations exceed the value of the property. As a final phase of the collection and delinquency survey, there is a detailed analysis of continuing real estate delinquency (forfeiture). This material is so assembled that the forfeitures may be located on maps, the duration and time of forfeiture summarized, and its relationships to special assessment delinquency shown.

Other aspects of local finance come in for somewhat less detailed treatment but about as complete analysis as can be made from existing records. Inasmuch as the superintendent of public instruction annually compiles some information on school district finances, these units have been omitted from this phase of the project, but for counties, cities, townships, road districts, park districts, public health districts, forest preserve, mosquito abatement, and sanitary districts, the data are to be assembled. Assembling this material has been a difficult and tedious chore because of the condition of the records, the unwillingness of some local officials to make their records available, and the very large volume of such material. The central office assumes almost complete responsibility for analyzing and classifying expenditures, and this has required that verbatim copies or nearly verbatim copies have been made of the records of most local units. The exceptions are those cases in which the local government has a comprehensive and analytical statements of its receipts and disbursements. A subsidiary aspect of the receipt and expenditure information has been the study of funded indebtedness. This, however, is not confined to the districts enumerated above, but includes every district within the state.

Finally, a very determined effort has been made to bring together information on special assessments. No other aspect of local finance is as much in the dark as this. Much of the data listed above while not assembled on a state-wide basis can be obtained from the records in the county court houses. On special assessments, however, not only are the data not available in any centrally located spots, but frequently can not be found in sufficient detail in the possession of officials charged with their keeping. Furthermore, the records on special assessments have been poorly kept, and as a result information that can be assembled from these sources is not only incomplete but in many instances unreliable. It does, however, constitute all that any one could gather with a reasonable expenditure of time and effort, and is regarded as satisfactory for statistical purposes. In addition to having a considerable volume of local improvements, Illinois has in the neighborhood of sixteen hundred drainage districts which have been in more or less continuous existence over a period

of several decades. Many are permitted to lie dormant for several years, and then when they start operations again, information as to the original set-up is hard to obtain.

From these various phases of local finance, we hope that with our regular staff we shall be able to present a series of reports which will at once offer a considerable volume of detail and brief summary statements and conclusions. We also expect to issue a series of monographs dealing in some detail with matters of specialized interest. It is to be hoped that other investigators in Illinois will make use of these data to study and analyze their own particular problems and that from a long-time point of view, sufficient importance and use will be attached to this material to more than justify the cost and trouble of assembling it.

This brief statement concerning the local finance survey will not be complete without some reference to the organization and operation of a project of this scope and size. We were fortunate in having a small but highly-trained staff of research workers at the time the project was first considered. We also had a staff of trained field supervisors who had contacts throughout the state, and were familiar with the materials with which we had to work. Furthermore, many of the phases of work included in the project had been studied on a sample basis with the commission's own slender resources, so that our plans were drafted with some knowledge of local conditions and the assistance of well-trained and competent personnel. Nevertheless, we failed by far to anticipate the problems and difficulties that have arisen. The major difficulty with this type of project is the divergence of objectives of the Works Progress Administration and that of the sponsor. The sponsor, of course, is interested in completing his work with a high standard of accuracy and with the maximum sized staff, over which its supervisors and technical staff can be spread. On the other hand, the Works Progress Administration is confronted with the task of putting needy people to work in the places and at the times where their resources and the needs dictate. These two objectives are continually running counter to each other, and cause no end of difficulty for the sponsor. The local finance survey involves a long training period for workers before they reach their maximum usefulness to the project. This, of course, places a heavy premium on retaining workers, an objective directly contrary to that of the W.P.A. which seeks private employment and other sources of support for all certified people. Furthermore, in any organization of the size of the W.P.A., the operating interests of a project of relatively limited scope will frequently be overridden by procedural and financial exigencies of the relief administration. Such happenings are very costly to the sponsor and damaging to the rate of production. A further difficulty arises in the employment of technical and supervisory help. Rates of pay which might have been regarded as fairly adequate in the earlier

years of the W.P.A. are hopelessly inadequate today. This places the entire burden of the administrative supervision on the sponsor. In our case, this has been difficult to assume. Despite all of these handicaps, my feeling is that the W.P.A. has done remarkably well in promoting our project. I think that some shift in emphasis from *make-work* to *accomplishing objectives*, though, might increase the man-year costs, but would in the long run be beneficial to both the federal government and the sponsor.

There has been a good deal of banter and no little seriousness of conviction that the W.P.A. work is inefficiently and ineffectually done. My observation is that in terms of output there is not a great deal of difference between regularly employed help in private business, in state and local government service, and in W.P.A., bearing in mind that rates of pay are somewhat lower and that the incentives of higher salary, promotion and prestige going with private or regular government employment are entirely absent. Our experience is not unfavorable to relief help.

One final word concerning our contacts with local officials as a result of this project. The tax commission has long had a field staff whose duty it is to assist and advise local officials in the assessment of property. The survey has multiplied and intensified the contacts with local officials. In order to operate in the field it was necessary for us to obtain liberal donations of space, light, and heat from all of the counties and many of the cities in the state. This cooperation has been forthcoming almost with no complaint. By far the greatest number of local officials, county, city, and township alike, have given freely of their facilities, time and information in order that the work might be done to best advantage. It is our hope that in the long run we may be able to repay these local officials in the same manner. The information secured from the project will certainly be of interest and benefit to them. Certainly the project has done much to draw together the state and the local taxing officials to give them a community and harmony of interest that had not been there before.

CHAIRMAN MITCHELL: Well, that puts me in rather a peculiar spot. I think I will let Mr. Leland say everything that is to be said for the two of us because he says it so well, and I shall continue to introduce Mr. Pond of the New York Tax Commission, who has thirteen minutes to tell you about the program of the oldest and best research department, I think, in the country as far as the tax commissions are concerned.

CHESTER B. POND: Mr. Chairman, Ladies and Gentlemen: A few minutes ago the chairman asked me if I could confine my remarks to twelve minutes. I shall endeavor to do so.

Perhaps I should explain to you before I start, so that you won't think I am presumptuous, that I am a new employee of the bureau

of research and statistics of the department of taxation and finance, having been with them three months, although I have been associated with Mr. Howard, the director of the bureau, previously, back in 1928-1930.

The bureau of research and statistics is, of course, like all organizations of its type, concerned with many problems which are of purely statewide interest and are not so significant from the standpoint of national taxation. Because there are two matters about which I wish to speak at some length, I am going to pass over the local aspect of our problems merely by saying that we have special assignments which we have to perform for Commissioner Graves from time to time and that we hope to be able to improve the annual report for which the bureau is responsible. There hasn't been so much done along that line lately but we are getting set to do something. I can't tell you any more than this at the moment because I don't know much more myself. But I promise you that we are going to endeavor to make it as good a report as we possibly can.

In 1928 Mr. Howard conceived and put into practice the idea of establishing tax fellowships at leading educational institutions of higher learning chiefly in the East. The intention was to take advantage of graduate study in taxation by placing fellowships at these institutions so that students who were working for their Ph.D. would have an opportunity to exploit the field of tax research for their own benefit and indirectly, of course, for New York state's. Mr. Howard divided the field of taxation into about 100 sub-fields which he thought deserved attention, and it was his hope to be able through continuance of these fellowships gradually to build up a group of men each one of whom would be an expert in some one of these sub-fields.

The success of the venture has yet to be measured fully due to the fact that when we were faced with the slump of 1929-1932 it became necessary to curtail the appropriations which went for these fellowships, so that after 1933 they were discontinued. However, eleven of them have been published and two more are in process and will be out shortly. Some of the men who worked on these are here in this room.

It is our hope, or it was when I prepared to make this statement to you, that we could reinstate these fellowships by 1938, (that is a year from now) and go forward even more assiduously than Mr. Howard did before. We hope that we will have sufficient funds to make it possible to increase the fellowships, say, to \$2500 and to have men who either have their Ph.D. degrees in taxation or who wish to go on and do some special work. The coordination of the fields of study will of course have to be continued if we are to round out the program in the sub-fields.

However, it is hoped that we will be able to push forward as soon as we can possibly get the funds. Those of you who know the con-

dition of New York state's finances are aware that we have reduced the deficit in the general fund to about \$10,000,000, and we have high hopes that at the end of the fiscal year, June 30, 1938, New York state will no longer be in the red.

This as I say was all framed in my mind to tell you before the recent stock market recession. What effect it will have on New York state's revenues we do not yet know. If the effect is to increase the deficit, then we may have to postpone for some time—no longer, of course, than we absolutely have to—the continuation or the reinstatement of these graduate fellowships in taxation.

The other thing which is of special interest to outsiders is a new departure which began with the issuance of the 1935 tax commission report for New York state, in which a tax chart of the administrative machinery of the general property tax in New York was included. There were 55 columns outlining the machinery from assessment and levying to collections of the tax, sale of delinquent tax property, and so on.

This employment of the, shall I call it, charting principle—that is, the idea of putting things down in chart form—parallels the work which has been done right along in *Tax Systems of the World* with which most of you are familiar. The reason for doing this is because we believe that taxation is at least 90 per cent administration and 10 per cent legislation. Hitherto all too much emphasis has been placed upon the legislative rather than the administrative side.

Professor Girard of New York University who was at this conference, but who has returned, is endeavoring to round up a chart for New York City as a starter on this program. From thence on we hope to be able to get comparable charts of other large cities, and to bind them together so that you can have something for comparative purposes. From the cities we can proceed to states.

After we have been able to push the general property tax to the desired limit it may then be possible to go over into the other taxes, such as income tax, inheritance tax, etc., and exploit each one of these in the same way, so that when we get through we will have for administrative purposes something which is comparable to *Tax Systems of the World* on the legislative side.

The plan seems rather grandiose, and I am not setting any date for its completion, but I think those of you who know *Tax Systems of the World* will agree that there we have a concrete embodiment of something which to me at one time seemed grandiose. After all if a thing is worth trying for the fact that its realization is remote and can't even come about in our own lifetime should not discourage us. If taxation is to be regarded as a science then we must be willing to have the patience of scientists and not expect to accomplish everything that is to be accomplished in the short span of one life.

Another question may have occurred to you in this discussion and that is, why is the New York State Tax Commission through its

bureau of research and statistics so interested in something which is not really in itself a state problem? The answer to that is as obvious to you as it is to me. If we wish to make the most of the opportunities which we have in research for New York state, we must go outside our borders to find out what is going on in other tax jurisdictions and, through comparison, correlation and study, select those things which we think are worth perpetuating. If this is to be accomplished then, of course, these comparative endeavors which I have indicated are going to be well worthwhile.

I see that I am getting somewhere near the deadline. Before I close I want to say to those of you who may have some queries in your mind about Tax Systems of the World, which as you know is affiliated with the New York State Tax Commission, that the seventh edition will be out very shortly, we hope, and that it will continue to expand along the lines of the foreword which those of you who have read it may recall. In that foreword a very grand scheme was outlined, but gradually and patiently I think it is being accomplished, and it is being accomplished through the voluntary efforts of literally hundreds of people who are willing to give their time and effort and services for nothing in order that in the field of taxation we may have something approximating a working encyclopedia.

This volume can never be any better than the efforts of those who contribute to it. It is inevitable that things will appear in it which are either erroneous or convey an interpretation such as to lead one astray from the facts. I would like to urge upon you that I would regard it as a personal compliment—and I am sure that Mr. Howard would—if you would communicate with us whenever you find anything which you think is either erroneous or which needs improving. We need all the help that we can get from collaborators and from those who hitherto have not collaborated, in order that this great cooperative effort may achieve a result approaching the vision which prompted it.

CHAIRMAN MITCHELL: It is just three o'clock, so I will turn the gavel over to Mr. Leser and if he wants you to stay any longer it is up to him.

PRESIDENT LESER: Before I start on my own speech I want to announce that this meeting is adjourned.

TWELFTH SESSION

THURSDAY, OCTOBER 28, 1937, 3 P. M.

PRESIDENT LESER: The twelfth session of the national tax conference will please come to order.

At this meeting we have a presiding officer for whom I entertain a very peculiar feeling of friendship and affection. He was the secretary of the Maryland State Tax Commission for the first four years of its existence, from 1914 to 1918. Then came the wonderful opportunities which arose under the administration of the federal post-war income tax legislation. You cannot blame him for having deserted us for a more lucrative field, and almost like our friend Saxe, he is now wrestling with the upper brackets.

A very notable service that he performed before he became secretary of that commission was as secretary of a special tax commission appointed in 1912 which came to the fortunate conclusion that it would be wise to establish a permanent state tax commission in Maryland. If they had not come to that fortunate conclusion I never would have been a member of it. Naturally, I am grateful to Mr. Girdwood who did the real tough work that had to be done on that commission.

I could say a great deal more but the more I talk the less time will be left for other people. Under these circumstances, I present Mr. Allan C. Girdwood as the chairman of this meeting.

CHAIRMAN GIRDWOOD: Thank you, Judge Leser.

Members of the Conference: In this turmoil of taxation I have probably done all lines of work—investigation, city government, state government, and federal government—and in a speech in Albany in 1915 I made this remark which comes home to me, and I suppose I will say it for the next ten years: "I see no relief from taxation in the succeeding years."

That statement was true in 1915 and it is true in 1937, unless bodies like the National Tax Association solve this perplexing tax problem.

I have been a member of the association since 1912. I was invited to the first conference in 1907. I also had the unfortunate distinction as a member of the legislature in 1910—I hope I may be forgiven for it—of having introduced in Maryland the resolution to ratify the sixteenth amendment to the constitution, which was the income tax amendment.

There is a very interesting story on the ratification of the sixteenth amendment in Maryland, because Maryland did not ratify the

thirteenth, fourteenth, or fifteenth amendments, and I had to go to the session of 1805 for precedent for introduction of the resolution for ratification of the sixteenth amendment.

It is not so much in the retrospect of taxation that we are interested, but in the prospect of taxation, and it should be the object of all administrators not to solve a tax problem for today but to look to the years to come and consider what will be the effect of that tax law five years or ten years from today.

It is not my purpose to take up your time, as the papers that are to be presented have been prepared with a great deal of care deserve your consideration.

The first paper on the program is a paper prepared by Mr. Snavely, professor of economics, University of Virginia, on "Progress in the Government and Finances of the Counties in Virginia."

PROGRESS IN THE GOVERNMENT AND FINANCES OF THE COUNTIES IN VIRGINIA *

TIPTON R. SNAVELY

Professor of Economics, University of Virginia

Slightly more than ten years ago, it seemed desirable to carry through an extensive reorganization of the state government of Virginia. The structure of the state government clearly had not kept pace with changing economic conditions, but was adapted to an era in the industrial life of the state that was rapidly passing out of existence. The general assembly, it is true, had endeavored to meet the increasing demands of government, for the number of agencies created had more than doubled in the previous two decades, but the additional bureaus and agencies resulted in a decentralization of authority and an overlapping of functions which marred the efficiency of the entire organization. Administrative responsibility had become "scattered, diffused and dissipated," and the costs of government were excessive in relation to the services rendered.

In the period from 1926 to 1928, the plan of government was simplified through the establishment of twelve administrative departments of state government. The constitution was revised to make possible the appointment rather than election of most state officials and these officials, in turn, were made directly responsible to the governor. Certain useless offices were abolished, while the governor lost some sixty appointments of boards and heads of departments. The financial system of the state was completely reorganized, one of the most important of all reform measures being the abolition of numerous separate funds and the conversion and disbursement of all state money through a single agency—the state treasury. The

* I am indebted to my colleague, Professor George W. Spicer, for valuable suggestions in the preparation of this paper.

tax system was modernized under a general plan of the separation of sources of revenue and the administration of the laws was vested in a well-organized state tax department, directed by a state tax commissioner.

The Honorable Harry F. Byrd, who as governor at the time, initiated and led through the general assembly, the broad program of government simplification, estimated that the savings effected thereby would approximate \$900,000. The real economies, however, were far in excess of this figure. The application of sound business principles to the administration of government enabled the state to weather the depression years with a minimum of loss in state functions and to realize a substantial surplus in the treasury at the present time.

It is not my purpose to review at length the benefits of legislative changes in Virginia's state government. No doubt similar reform measures have been enacted in many or all of the various states. We are aware also that the vast majority of cities have found it expedient to reconstruct the general procedure of government under which they operated twenty or thirty years ago. The cities have been compelled to eliminate antiquated and cumbersome methods of conducting the business of government. But what can be said of the 3,062 counties of the United States? What progress is being made in the improvement of county administration? It is the object of this paper to survey some of the recent changes in county government in Virginia, as related primarily to its financial aspects.

In any study of the 100 counties of Virginia, it is necessary to observe the wide range both in area and population which is to be found among them. The average area is 401.2 square miles, as compared with an area of 985.6 square miles for the average county in the United States; but fifty counties have an area which is below the state average. The smallest county contains an area of only 25 square miles, while that of the largest county is 1,012 square miles.

The average population for all counties in Virginia is 17,188.9 persons—a figure which is less than half of the national average of 39,991.5 persons. Only three counties of the state have a population equal to the national average, while fifty-nine counties are below the average. The population in the smallest county was 3,562, and thirty-one counties under the census of 1930 had a population of less than 10,000. Under these conditions, it goes without saying that there are wide differences among the counties in their ability to provide the services of government for their citizens. In forty-six counties the assessed valuation is less than \$5,000,000, while in twenty-four counties, it is less than \$3,000,000.

The counties of Virginia had a total expenditure in 1913 of \$8,000,000. This expenditure had increased by the year 1930 to \$29,498,000, but declined by almost one-third of this amount in the years 1933 and 1934. For the year ending on June 30, 1936, the

expenditures rose again to a figure of \$23,368,794 and amounted to 20 per cent of the total state and local expenditures. The per capita cost of county government averaged \$16.17 in 1931, dropped to a low point of \$10.71 in 1933, and rebounded to \$13.60 in 1936. In the latter year, about two-thirds of the total expenditure went for operation and maintenance, 18.5 per cent for capital outlay and approximately 13 per cent was about evenly divided between requirements for interest and the public debt.

In its report of 1931, the commission on county government in Virginia stated that while some progress had been made here and there, in respect to "administrative organization and structure the counties of the United States occupy substantially the same position they occupied generations ago." The counties of Virginia, the commission said, "are operating under a form of organization which was embodied in most essential particulars in the state constitution of 1852." But while there has been no essential change in the structure of county government, it is noteworthy that the counties and cities of Virginia are separate and distinct political units. In a paper presented by the writer before this association in 1925, it was pointed out that the 24 cities are entirely independent, territorially and governmentally, from the counties in which they are located. Each city is a separate taxing unit, as taxes imposed by a county do not apply to the incorporated property of a city within its borders. A similar relation does not exist between the counties and towns, the latter being in a position somewhat like cities in other states, each town being a part of the county wherein it is located, both territorially and governmentally.

The origin of the counties and cities as separate entities of government may be traced to the strong feeling for local self-government which has prevailed in Virginia from early times. The local communities are given a maximum amount of freedom for governing themselves. It is true that the amount of home rule is being substantially modified as local functions are transferred to the state or as the state exercises supervision and control of local action through grants in aid. The fact remains, however, that the counties are free from confusion and bewilderment which exist where there is an overlapping of jurisdiction between counties and cities.

Except for two counties which have adopted a new form of government, to be considered presently, the general plan of county organization in Virginia involves some thirty or forty administrative offices, which are in some instances elective and in other instances appointive. They are in part, also, constitutional and in part have been created by the general assembly. The jurisdiction of certain officers is limited to a particular area of a county, such as a magisterial district, whereas others have county-wide jurisdiction. Since the principal officers of the county are elective, it may be asserted that here we find the purest form of democratic govern-

ment and that, accordingly, we should expect to find a type of government that would function with the highest degree of efficiency. Yet we know that in practice under this system there is a lack of co-ordination, a diffusion of responsibility, a decentralization of authority and an absence of leadership, the general result of which is haphazard government.

In its first report, the continuing commission on county government has given a sort of blueprint, as it were, of the administrative structure of one of the larger counties in the state. Not including the circuit judge and the officers constituting the election machinery, there were in this county "30 separate and distinct offices, manned by more than 80 administrative or semi-administrative officers." Ten of these offices, comprising twenty-five officers, were filled by the circuit judge—an officer who is elected by the general assembly. Various state departments and commissions were responsible for the appointment of nine officers. Thirty-eight officers, most of whom were constables and justices of the peace, were elected by the people, and a majority of these were elected from magisterial districts rather than on a county-wide basis. The remaining 22 officers were appointed by the agencies and boards already established. "Thus we find thirty offices," said the commission, "manned by eighty-odd officers, engaged mainly in directing the functions of a county which spends approximately \$600,000 a year." The smaller counties have the same rigid uniformity of organization and offices, though the number of officials may be smaller because of fewer magisterial districts.

In seeking an answer to the question of whether substantial improvement has occurred in the government and in the finances of counties, two lines of inquiry may be followed. We may ask first whether progress has been made within the limits of the characteristic form of organization. Has there been improvement in the methods and technique under the general status of the present system? In the second place it may be asked whether there is a tendency toward a change in the form of organization, and whether a radical change in organization will enable the counties to function adequately as local units of government? These questions may be considered in order.

Such progress as has been made under the plan of organization which has long obtained in the counties is primarily financial in nature. Note, for example, the fee system. From 1772 until 1914, there was little, if any, modification of the system under which local officers were allowed to retain all of the fees collected from their offices. In the latter year the general assembly passed an act intended to limit, though not to abolish, the compensation of officers by fees. The act was designed to fix a maximum compensation for officials and to create a state fee commission which should determine the proper expenses to be charged to the respective offices. For

several years, however, the commission was not able to operate effectively.

The "West Fee Bill" was gradually strengthened in subsequent sessions of the legislature until in 1932, both county treasurers and commissioners of the revenue were placed on a salary basis. The salaries fixed were based on the net compensation of these officials in 1930 and local boards of supervisors were granted authority to increase or decrease the compensation by 15 per cent. The expenses of both offices must be approved by the board of supervisors and by the state fee commission—the title of which is now the state compensation board. It should be noted that the salaries of both officers are paid jointly by the county and the state. For the year 1933, under the salary basis, the total cost of both officers declined by the sum of \$204,717.09 as compared with the year 1930. Not only has there been a notable reduction in costs, but also a highly beneficial result is the fact that the boards of supervisors have "some voice in determining the salaries and expenses of these two offices."

In 1934 the office of attorney for the commonwealth was placed on a salary basis under the compensation board and the board likewise supervises the fees and expenses of the offices of sheriff, clerk of the court and examiner of records. A significant change which was made in 1934 relates to the magistrates or justices of the peace in counties. The work of these officers has now largely been superseded by the creation of a single trial justice for each county who does not depend upon fees for a stipend but is paid a regular salary. Justices of the peace are restricted to the issue of warrants only in the particular magisterial districts which they represent. Whatever merit there may be in the fee system as a means of providing special services to the citizenry rests on a different principle from that of compensating officers through fees. Such fees should be paid into the treasury and with few exceptions the officers should be paid from salaries. A great stride forward has been made by the counties as regards the fee system.

The general assembly passed an act in 1927 making it mandatory upon the board of supervisors in each county to prepare annually a budget "containing a complete itemized and classified plan of all proposed expenditures and all estimated revenues and borrowings for the locality and in any subdivision thereof for the ensuing appropriation year." This attempt to have the counties plan their receipts and expenditures in a systematic manner was a step forward, but has not been followed both in the letter and spirit in all counties. In its report of 1931, the commission on county government pointed out certain weaknesses of the county budget act. In the first place, the important functions of roads and schools were not included. This is especially important in reference to schools, since in practice the local school board rather than the board of supervisors is in

charge of school finances. The relationship between the board of supervisors and the county school board has in many instances proved far from satisfactory. Probably the responsibility for the entire budget should be centralized in the board of supervisors. Indeed there are strong arguments in favor of merging the school board with the principal functioning board of the county.

Another weakness is that although the budgets of counties are to be filed with the state budget director, many are careless in complying with this requirement. Hence there are no means of checking the counties in respect to their adherence to the budget as drawn. It may be said that, if compulsory power over the administration of local budgets is vested in a state agency, another dent will have been made in the armor of home rule, but if such power extends only to the conformity with a properly prepared budget, it does not seriously trench upon the local authority.

One of the most progressive measures ever applied to the counties is the annual audit of their finances by the state auditor of public accounts. In the words of the committee on taxation of the Virginia State Chamber of Commerce, Virginia has one of the "best accounting and auditing systems existing in any of the states of the union." Unfortunately, there are several special funds, and district levies and accounts which are not included in the audit. Based on the facts of his audit, the state auditor of public accounts issues each year an illuminating report on the comparative cost of local government, making possible a detailed comparison of the costs of the respective functions of government in the different counties. An exhibit is made, too, of the revenue as collected from all local sources. It is a striking fact that since the establishment of a state audit of the counties, the premium cost on the bonds of local officials has substantially declined.

In the matter of indebtedness the counties are in a relatively favorable position. There are only seven counties which have either a gross or net debt of \$1,000,000. The total net amount of the debt of all counties on June 30, 1936, was \$25,552,018.22, or the equivalent of \$14.87 per capita. An analysis of the total indebtedness in 1934 showed that 51.7 per cent had been incurred for roads, 36.9 per cent for schools, and 11.4 per cent for other purposes. In the same year, 17.07 per cent of the total cost of county government was attributable to debt service. Except for the purpose of meeting casual deficits or in lieu of revenues quickly anticipated, proposed issues of bonds must be submitted to the qualified voters for approval or rejection.

The main sources of revenue of the counties are taxes, state aid, and since the year 1934, small federal grants. For the year 1936, 64.79 per cent of the total revenue was derived from local sources, 30.35 per cent from state aid and 4.86 per cent from federal supplements. Approximately 30 per cent of the total revenue is in the

form of state grants-in-aid, the overwhelming proportion of which is allocated to the public schools. By far, the major item of county expenditure today is that of the public school system. Of each dollar expended, in 1936 63.52 cents went for this purpose—thus leaving 27.89 cents for the cost of administration and 8.59 cents for roads. If it may appear extraordinary that such a small percentage of each dollar is appropriated for roads, it should be remembered that beginning in 1933, the state assumed the principal burden of county roads by establishing a secondary system of state highways.

Under the plan of segregation adopted in 1926, the tax sources left to the counties are real estate, tangible personal property, machinery and tools, merchants capital, local capitation taxes when imposed and a proportion of state license tax upon dogs. Except for real estate, assessments are made annually. Real estate assessments, except for a few of the more densely populated counties, are made only at such intervals as the board of supervisors may deem expedient. I need not dwell on the inequalities of assessments or the inequities in the distribution of the tax burden as between counties, counties and cities, and among individual tax payers. Suffice it to say that they are as marked as those in other states and that little improvement has been made within the memory of living men. Recently complete tax maps for certain counties have been prepared under the direction of the economist for the state tax department, Dr. W. H. Stauffer. These now form a basis for a more scientific assessment for such counties as may desire to take advantage of their use. While all counties are required to have boards of equalization consisting of three to five members who are appointed by the courts, with one or two exceptions their work has been negligible.

Let us turn now to a second possible avenue of reform in county government and finance in Virginia—that of a change in the internal organization. The constitution was amended in 1928 to make possible the consolidation of existing counties on a vote of a majority of the qualified voters of each of such counties voting at an election held for that purpose. It also provided that no new counties should be formed having an area of less than 600 square miles or a population of less than 8,000. At the same time the general assembly was authorized to provide for different forms of county organization and government, to become effective in any county when approved at an election by a majority of the voters.

Pursuant to these changes in the constitution, the general assembly passed an act in 1930 creating a commission on county government, among the duties of which was to draft a general law setting forth optional forms of county government, to investigate the operation and costs of county government, and to study comparative county government in Virginia. In its report to the general assembly of 1932, the commission emphasized the need for a change in county organization and submitted proposals designed to improve both the

organization and procedure in the counties. It recommended three alternatives which might be followed. These were, first, a very flexible county executive form; second, a county manager form; third, a continuation of the old form with special measures for its improvement.

Of the two new types recommended, the county manager and the county executive forms, the principal difference lies in the relation of the executive officer to the board of supervisors. Under the county manager plan the full authority of government is vested in the board of supervisors. The board itself is elected by the people and represents the county as a whole rather than specific magisterial districts. It is essentially a policy forming body with respect to all legislation, taxes, and expenditures, but the administrative work is performed under an executive agent selected by the board as county manager. The manager selects his staff of subordinates who are directly responsible to him, he in turn being immediately responsible to the board of supervisors. The county manager is thus a coordinating as well as an administrative officer. It is his duty to prepare and submit to the board a general budget including an effective system of accounting. The plan is not only intended to provide responsible government, but also to eliminate useless offices and needless overlapping and duplication.

As was suggested above, the county executive form is very similar to the manager form, the board of supervisors again being the responsible, policy forming agency, but the board in addition to appointing its own administrative officer, itself appoints the subordinate officials upon the recommendation of the county executive. The concentration of administrative responsibility is diluted somewhat perhaps as compared with the county manager form. The commission believed it to have the advantage of being more flexible.

The optional forms recommended were enacted into law by the general assembly of 1932 by an overwhelming majority, with but one important amendment—that making the sheriff an elective office. Since that time five counties have held elections on the adoption of one or the other of the two plans. Two counties voted in favor of a change—Albemarle for the county executive form and Henrico for the county manager plan. Incidentally, two other counties, Roanoke and Chesterfield, are holding a referendum on the question at the forthcoming election.

What now have been the results of the operation of the new forms of government for a period of three years in the counties of Albemarle and Henrico? Under the executive plan, the cost of operating the finance department, including salaries of the purchasing agent, treasurer, commissioner of revenue and supervisor of accounts averaged for the three years the sum of \$8,446.03. On a comparable basis, the net cost for the year ending in 1933, under the old system was \$21,395.21. During the three-year period, the

county received fees from the state and city for the maintenance of prisoners an amount of \$26,338.06. Since the cost of supplying the provisions was \$10,638.72, the county made a handsome profit. Prior to this time, the profit went as accruals to the jailer and sheriff in the form of fees. The surplus in the general operating fund on July 1, 1934, was \$40,001.83. This was increased to \$81,881.12 on June 30, 1937. The surplus in the school fund for the same period jumped from \$7,299.48 to \$13,347.82, and the surplus in the general fund might have been larger had the county not built a fireproof storehouse containing 6,000 square feet.

Under the plan the county has enhanced the efficiency of its services in various ways. It has employed an additional nurse and a full-time dentist in public health work. It has also increased the appropriations for public welfare and law enforcement. Under the old system, special deputies were engaged from time to time. Usually they were farmers or merchants. Now there is a full-time officer who is paid from the saving in the operation of the jail.

The tax rate for purposes of the general fund has been reduced by 16 $\frac{2}{3}$ per cent during the three years in which the county executive plan has been in effect. It is interesting to observe that the percentage of tax delinquency has declined from 20.5 per cent in 1933 to 10.6 per cent in the fiscal year of 1936. The rate of delinquency for all counties on property taxes in 1936 was 14.7 per cent. Both in Albemarle and Henrico, there has been a steady reduction in the county debt.

The experience of Henrico County has been equally significant under the county manager plan. Its government has been set up much like the pattern of a business corporation, the functions being divided into five departments; finance, public welfare, public works, health and education. The sheriff, attorney for the commonwealth, and clerk are still elected by the people. The department of finance is so operated that any citizen on any day can ascertain the status of county finances. It is asserted that as a result of the savings effected, the county now supplies an equivalent of two fifths more in services than was true under the old system. There has, for example, been a saving of \$15,000 in the purchase of gasoline and asphalt, of more than \$2,000 in cash discounts of bills, of 20 per cent on insurance premiums, of \$27,671 in salary expenses through the abolition of the fee system, and in other items. Tax rates have been reduced by a small percentage and tax delinquency has been greatly curtailed. Through two subsequent special elections an effort has been made to persuade the voters to return to the old plan of government, but on each occasion the new form has been upheld by a decisive majority. Such assertions of criticism as have been voiced have in no wise been convincing.

Those who are pessimistically inclined argue that progress in the adoption of the new forms of county government is likely to be in-

ordinately slow. Many of the counties may lag indefinitely in the establishment of progressive government. Yet it should not be forgotten that under state legislation the financial affairs of the counties have been measurably advanced and will continue to be improved. It is not unlikely that at an early time in several remaining counties, greater economy and efficiency in government will come as an issue before the electorate.

Furthermore, it is increasingly apparent that a mere change in organization cannot bring an ultimate solution of the problems confronting many of the smaller counties. These counties do not possess sufficient resources to maintain an efficient local government of any type. They are too small in population to provide a satisfactory or economical unit for the distribution of the various services required. Doubtless the size of the county providing an optimum point in the efficiency of operation may vary with time and circumstance, but we know that an area of a few hundred square miles and having a sparse population is too small.

Realizing this condition, the commission on county government in its report of 1934, recommended that the counties put aside the inertia of tradition and the pride of name, and that they effectuate feasible plans of consolidation. It pointed out that consolidation may be functional or geographical. Some progress has been made in the functional consolidation of schools, public health, and public welfare. The possibilities of such consolidation, however, are distinctly limited. Hence the commission recommended geographical consolidation as "the only solution if small counties wish to remain areas for local self-government."

In its report for 1936, the commission suggested a possible regrouping of the hundred counties into thirty-one regional districts. This was done without cutting across county lines. The thirty-one administrative districts would vary in area from 417 square miles to 2,155 square miles and in population from 22,397 to 105,767. The commission expressed the belief that under a manager or executive plan, districts of this sort would bring an economic gain to the taxpayer of 25 or 30 per cent. Other important advantages would be an improvement in the quality of government personnel, more efficient service and the preservation of local government to an extent not otherwise possible.

In spite of the deeply rooted attachment to local home rule which has prevailed in Virginia from the founding of the colony, perhaps it might as well be conceded that local self-government can hardly be preserved in its earlier form. Those services which partake of the nature of large-scale businesses can be operated more efficiently by the state itself. An example of such a business is roads—and, as Dr. Stauffer pointed out in a paper read before this body in 1934, "administrative control and fiscal responsibility go hand in hand."

Yet it must be recognized that the state government itself is far closer to the county and to the community in a real sense than it has ever been. The sentiment of a county can be made manifest to a state agency far more quickly and more forcefully than in the past. The state agency can never afford to ignore the sentiment of the people of a county voiced through its local representatives. What is lost in the direct surrender of local functions to the state government is in part regained indirectly through a much closer relationship between the counties themselves and between the counties and the state. To this extent there is a mutual gain.

CHAIRMAN GIRDWOOD: I am going to refer the paper to those states in the southeastern part of the United States in which the conditions set forth in this paper are, in my opinion, very similar, particularly our own state of Maryland. Many of the conditions which Mr. Snavelly found, exist in this state. When I read the title, I was wondering how in the world he was going to get progress in government and finance, and I think his paper proves the improvement in government and finance.

Mr. Query would like to make a statement.

SECRETARY W. G. QUERY: The thirteenth and last session of this conference will not be held in this room but will be held in the parlor in which the luncheon session was held today, that is, the parlor to my left. The hotel management has requested me to make this statement. They say they understand that a great many delegates are leaving after the evening session. They respectfully request that you pack your baggage and in the event they sell any of the rooms, they will bring your baggage down to the baggage room and hold it there for you until after the meeting. This does not apply to those who are going to stay over until tomorrow.

CHAIRMAN GIRDWOOD: The next speaker on the program is the report of the committee of the National Tax Association on double domicile in inheritance taxation. This subject is of sufficient importance to have been before the conference at the last three sessions, including this one. This is the third report on the subject.

While the subject affects only a few persons, or a few states, the subject matter of itself is of grave importance.

I have pleasure in introducing Mr. Knapp of Connecticut who will read the report of the committee.

THIRD REPORT OF THE
COMMITTEE OF THE NATIONAL TAX ASSOCIATION
ON DOUBLE
DOMICILE IN INHERITANCE TAXATION

FARWELL KNAPP, CHAIRMAN

When this committee was continued at the Indianapolis conference of the National Tax Association a year ago, the vote of continuance specified that, in addition to duties theretofore cast upon it, the committee consider and report on the feasibility and practicability of utilizing (a) interstate compacts, and (b) the establishment and promulgation within and by the various states of a uniform law on domicile for inheritance and gift taxes.

With respect to the matter of the establishment of a uniform law on domicile, your committee has studied the problem and conferred with various leading authorities. As the result of this, your committee believes that, in the first place, the law of domicile in the various states of this country is, with minor exceptions, already uniform. It would not seem that the formal enactment by all of the states of an identical statute setting out the requirements of domicile with respect to inheritance and gift taxes would be particularly useful. In the second place, even if such a uniform law were formally passed by each state, it is not believed that it would help to solve the problems arising in the so-called double domicile cases. The difficulty in these cases is not to find what the law is, but to apply the facts to fit the law. Facts cannot be brought within any uniform law. As pointed out in a previous report of this committee, if the same domicile case is tried before two courts of different states, it may be that some facts will not be available for proof in one court although they are in the other court; or it may be that exactly the same facts are presented to each court, and yet each court may give a different weight to the facts and thereby arrive at opposite conclusions. It is not perceived how this could be cured by the passage of a uniform law on domicile.

The second report of this committee discussed at length certain pending litigation, especially the Green case and the Hunt case. Both of these are now pending in the supreme court of the United States and will probably not be decided by the time this third report is delivered. In view of the importance of the questions involved in these two cases, your committee thinks it advisable to wait until the decisions are handed down before attempting to make any definite recommendations for the solution of the problem of double domicile in inheritance taxation; because it is not impossible that the solution may be indicated in one or the other decision. This report, therefore, will confine itself to a discussion of these cases and of the matter of compacts between the states. It is planned to

have a round table discussion thereof after the presentation of this report, at which time it is hoped that certain phases of the problem will be fully discussed, in order that the committee may be assisted in the formulation of any future recommendation.

Discussion of Litigation.

The Green case is entitled the State of Texas v. The State of New York, et al., the United States Supreme Court, October term 1936, #13 Original. The question involved is the domicile of Colonel Edward H. R. Green, who died June 8, 1936, leaving an estate of over fifty million dollars. The state of Texas brought original action in the United States Supreme Court against the states of New York and Florida and Massachusetts and also against Hetty Sylvia Ann Howland Green Wilks (decedent's sister) and Mabel Harlow Green (decedent's widow). These individuals were the sole heirs, next of kin and legatees of decedent. The plaintiff, state of Texas, prays that the United States Supreme Court determine the domicile of the decedent at the time of death. The various defendants having answered, the supreme court accepted jurisdiction of the case and has appointed a master to take testimony and report. The taking of testimony will probably consume a considerable time, so that an early decision of the court is not likely.

The Hunt case, now entitled Riley, Comptroller, et al., v. Worcester County Trust Company, executor, is likewise pending in the United States Supreme Court on writ of certiorari which was recently granted from a decision of the United States Circuit Court of Appeals in the First Circuit. It will be recalled that this action was commenced by the executor of Robert H. Hunt, deceased, in the United States District Court for the District of Massachusetts, the action being based upon the Federal Interpleader Act as amended in 1936, the bill praying that the district court determine decedent's domicile at death and enjoin the taxing authorities of whichever of the two states (California or Massachusetts) was determined not to be the domicile, from prosecuting claims for inheritance taxes against the estate. Massachusetts answered, while the California respondents moved to dismiss. The district court denied the motion to dismiss. The California respondents appealed to the United States Circuit Court of Appeals for the First Circuit, which court reversed the district court on the ground that the Federal Interpleader Act did not contemplate the impleading of states as adverse claimants, but only citizens of different states, and, if it did, congress would have acted in excess of its authority under the eleventh amendment to the constitution in attempting to confer such power upon the district courts, since original jurisdiction of suits between states is conferred upon the supreme court; and that the respondent tax officials must be treated, not as individuals, but only as representa-

tives and agents of their states. The executor thereupon petitioned the United States Supreme Court for a writ of certiorari, which writ was granted. It seems probable that the case will be argued and a final decision handed down some time during the 1937 term. As pointed out in the second report of this committee, if it is decided that the action lies under the Federal Interpleader Act as amended, and that the eleventh amendment to the constitution of the United States does not stand in the way, then a solution may have been found for the problem of double domicile, although such solution would not be satisfactory to some of the states. On the other hand, if the suit fails, it seems probable that some legislation will be necessary to solve the problem. Just what such legislation should be, your committee is not now prepared to state.

Mention should also be made of the McShea case, the full title of which is Edwin C. Nevin, surviving executor of the last will and testament of Walter Ross McShea, deceased, et al., v. J. H. Thayer Martin, tax commissioner of the state of New Jersey, et al. This is a case of disputed domicile, either in Pennsylvania or New Jersey. The case is pending in the United States District Court for the District of New Jersey. It involves the question of whether the federal courts may take jurisdiction of a double domicile case under the injunction section of the judicial code—thus differing from the Hunt case, which involves the Federal Interpleader Act. There are many who feel that the injunction section of the federal code offers a solution to our problem; but the case is not far enough along to indicate any answer.

With respect to the Green case, it is not certain whether the supreme court's determination of domicile will be for tax purposes only, or will be for other purposes such as that of devolution. It is the claim of Mabel Harlow Green, decedent's widow, that any determination of domicile made by the supreme court will be binding upon all of the parties, not only for tax purposes, but also for the purpose of distribution of the estate of the decedent to the person or persons thereunto entitled under the laws of the state so determined to be the domicile. If Texas proves to be the domicile, the community property laws of that state will be claimed to govern the devolution of all the intangible personal property of the decedent. This question will doubtless be decided at some stage of the Green case.

Another question which has not yet been settled in the Green case, and may not be finally settled in that case, is the extent of the jurisdiction of the supreme court in such a double domicile case. From colloquies between court and counsel at the preliminary argument in the supreme court, which resulted in the filing of an amended bill of complaint by the state of Texas, it appeared that one factor—or possibly the only factor—which induced the supreme court to take jurisdiction was the fact that the death tax claims of

the four states exceeded the total estate, so that as to the excess there was a real conflict between the states. If this is the extent of the jurisdiction, the method of proceeding by an original bill in the supreme court is very limited because it will seldom occur that the tax claims of the states will exceed the total estate; and, if so, this method of procedure will not be available in most cases of double domicile, so that the problem before the committee largely remains unsolved.

On the other hand, there are those who claim that the jurisdiction of the supreme court in such a case is broader than as indicated above, and would extend to any case where there was not sufficient property within the borders or within the jurisdiction of one of the claiming states to satisfy that state's tax claims. On this point it seems to your committee that in such case such claiming state could assess its tax, reduce it to judgment, and then sue in a federal district court in some other district where there were sufficient assets, relying on *Milwaukee County v. M. E. White Company*, 296 U. S. 268 (1936). Assuming, of course, that the taxing state had jurisdiction of the taxpayer and was, therefore, in a position to recover a judgment *in personam*, it would seem to follow that if recovery could be had on that basis by such claiming state, then there would be no controversy between the states which would enable the supreme court to take jurisdiction of an original bill. This question is as yet unsettled; but even if it were settled in favor of a wide jurisdiction on the part of the supreme court, yet such solution would cover only a part of the double domicile cases which arise, because in many cases there is sufficient property in both states (if there are only two claiming states) to satisfy the claims of each state. In such a situation it seems that an original bill in the United States Supreme Court could not be filed, but that each state might go ahead and enforce its whole tax claim, and thereby subject the estate to double death taxes.

It would appear, therefore, that no matter what the exact jurisdictional limits of the Green case turn out to be, no complete solution of the problem will be found in that case.

Discussion of Interstate Compacts.

This committee was directed to report on the feasibility and practicability of utilizing interstate compacts as a solution to the problem of double domicile. A solution through the use of interstate compacts would not differ very much from a solution through the use of reciprocal legislation between the states. The differences between these two methods are not numerous and will be commented upon in detail. At the present moment, while litigation is pending which might conceivably result in a solution being found through the courts, it would be premature for this committee to make any

definite recommendations as to the advisability of utilizing either interstate compacts or reciprocal legislation, or to suggest the form thereof. Nevertheless, it would be the part of wisdom to consider both of these possible solutions at the present time. Your committee has made some study thereof, and proposes to have the matter of reciprocal legislation discussed at the round table which is scheduled to follow this report. It is hoped that at such round table such a full discussion may be had as will materially assist your committee in crystallizing its ideas.

The allied subject of interstate compacts may properly be discussed in this report, especially since this committee was directed to report on it. What follows is summarized by your committee from the articles upon the subject, (a) Chapter 24 of a book entitled "State Government and Administration in the United States" by Professor Arthur W. Bromage of the University of Michigan (1936, Harper & Brothers), and (b) an article entitled "Interstate Compacts and Social Legislation" by Jane Perry Clark in "Political Science Quarterly", Vol. 50, pages 503-524, and Vol. 51, pages 36 to 60.

For a solution of problems involving two or more states, interstate compacts have on occasion been negotiated with the consent of congress. Under the constitution, no state can without the consent of congress enter into any agreement or compact with another state. By this limitation on their authority, the constitution indirectly recognizes the power of the states to enter into interstate compacts provided they can obtain congressional consent.

In the formulation of an interstate compact, the legislatures of the states involved customarily start proceedings by authorizing the creation of interstate compact commissions. After the commissions of the respective states have agreed to a compact, it next goes to the state legislatures for ratification. Consent of the congress of the United States is then necessary. However, the constitution does not state when or how congressional consent shall be given. Acquiescence to the terms of a compact may precede or follow the making of the compact or agreement. Moreover, consent may be implied from acts of congress and need not be expressly given.

Congress has on occasion given its consent in advance to interstate compacts dealing with a definite subject. In 1911 it authorized interstate compacts for the conservation of forests and water supply. In 1934 congress gave a blanket consent in advance to interstate compacts for cooperative state effort in the prevention of crime. In 1936, congress gave its consent to interstate compacts relative to the production of tobacco.

The necessity of independent authorities arriving at mutual agreements by negotiations makes the establishment of interstate compacts a long process. Since the consent of all states involved and

of the congress of the United States is essential to the modification of the terms of any compact, readjustment becomes as tedious as the initiation. Again, there is the question of enforcing the provisions of a compact. By failing to make necessary appropriations or by neglecting to take positive action necessary for fulfillment of its obligations, a state may in effect nullify an interstate compact.

Disputes between states over boundaries, rivers and harbors have been successfully settled in the past by this method. Interstate compacts in regard to regional problems of a general controversial nature have not yet proved their worth. One of the difficulties with such compacts in the field of social legislation is their inflexibility. The possible subjects which might be treated by interstate compacts have a wide range.

Some recent compacts may be listed as follows: (1) 1919, Hudson River Tunnel; (2) 1921, Port of New York Authority; (3) 1921, Colorado River; (4) 1928, Boulder Canyon; (5) 1934, Minimum Wage Compact by seven states; (6) 1935, Conservation of oil and gas.

Procedural, constitutional, and practical difficulties beset interstate compacts in such fields as that of social legislation. Delay is inevitable. It is a long road from the creation of a commission in order to negotiate a compact until final ratification by the respective states is secured and congressional consent is obtained. Either amendment or revision entails additional negotiations since constitutional issues may be raised by any process short of the formulation and ratification of a new agreement. Delegation of state legislative power to such an interstate administrative organization may raise constitutional issues. Again, some interstate compacts may interfere with the power of the federal government to control interstate commerce.

If one state enacts a statute to take effect upon the passage of similar legislation by another state, the legislation is reciprocal, but if the representatives of two or more states confer and agree on lines of action to be followed by the states concerned, the agreement then constitutes a compact. It is held by some that this difference is one of form only. The essence of a compact, in any event, is the intention to create a binding agreement between the states concerned. Even though reciprocal legislation often approaches the status of a compact, it is differentiated by the fact that it does not require the consent of all parties concerned for alteration in its terms, and particularly by the fact that it does not require congressional approval.

Ordinarily there is some formality about procedure; the commissioners designated by the states sign an agreement and then recommend action thereon to their respective state legislatures. There are, however, instances in which the action of the commissioners may be regarded as of a binding character. Thus the agree-

ment establishing the Port of New York Authority takes a short cut by providing that the compact

"When signed and sealed by the commissioners of each state as hereinbefore provided and the attorney-general of the state of New York and the attorney-general of the state of New Jersey if he be designated so as to act by the state of New Jersey, shall become binding upon the state of New York and shall be filed in the office of the secretary of state of the state of New York."

To prevent states from slowing up action until they are sure what other states are doing in the matter, the Minimum Wage Compact contains a further safeguard that it will take effect when ratified by two or more states.

There are various methods by which the assent of a state to a compact may be given, such as a joint resolution of the state legislature (*State ex rel. Baird v. Joslin*, 116 Kan. 615, 227 Pac. 543--1924) a statutory offer by one state and acceptance by another (*C. & O. Canal Company v. B. & O. R. R. Company*, 4 Gill & Johnson—Maryland 1932) or parallel legislation incorporating an agreement previously drafted by the representatives of the states party to the compact.

An interstate agreement takes effect immediately on ratification by the requisite number of participating states, if congress has previously consented.

The compact device must continually be examined with an eye to its flexibility and adaptability. It creates rights which may be altered only by the consent of the parties and is, therefore, built more firmly into the legislative structure than reciprocal action on the part of the states concerned.

If a compact contains provisions which limit its duration or which require periodic approval by the legislatures of the states in the agreement, it at least calls attention to the need for regular revision.

Obviously it is impossible to foresee all problems that may arise in a changing field. The situation may develop that mere amendment of a compact will appear insufficient and a state may therefore desire to withdraw completely from its obligations. If the original agreement stipulates a time limit or the terms under which it may terminate, the situation is comparatively simple.

In the absence of provisions for renunciation, in theory a state may not repudiate an existing compact any more than it may enact legislation controverting its terms.

Rhode Island v. Massachusetts, 12 Pet 657, 4 Howard 591.

C. & O. Canal Company v. B. & O. R. R., *supra*.

Virginia v. West Virginia, 11 Wall 39, 220 U. S. 1.

Kentucky v. Indiana, 281 U. S. 163.

As a matter of practical fact, states have occasionally resorted to the last extremity of absolute repudiation, and there is little that can be done about it. A state may also fail to provide funds for administration.

In social legislation, compacts often require administration by a permanent body such as the Port of New York Authority. It is doubted, however, whether a tax compact providing for arbitration would require any continuing administrative body.

In conclusion, it seems to your committee that it is not yet possible for it to make any recommendations. After various pending litigated cases have been brought to a conclusion; after a round table discussion has been had relative to reciprocal legislation, both as to advisability and form; after the results thereof have been compared with the problems arising in connection with interstate compacts, it may be that some sort of final recommendation can be suggested. We do not promise anything; it is within the bounds of possibility that the central problem is insoluble in a practical sense; but we hope it is not, and we believe the problem is so important that we shall make every effort to solve it.

For these reasons, we suggest that the committee be continued another year.

Respectfully submitted,

COMMITTEE ON DOUBLE DOMICILE
IN INHERITANCE TAXATION.

SETH T. COLE
WILLIAM D. KELLY
WM. H. H. GENTRY
RAYMOND D. THOMAS
FARWELL KNAPP, *Chairman*.

DRAFT #1 OF PROPOSED RECIPROCAL LAW

Sec. 1. *Definitions.* In the construction of this act the following words and phrases shall have the following meanings, unless the context clearly indicates otherwise: "fiduciary" shall mean the executor or executors, administrator or administrators, of the estate of a decedent; "tax commissioner" shall mean the state tax commissioner when referring to this state, and shall mean, when referring to another state, the state official or body of officials charged with the duty of administering death taxes in such other state; "death taxes" shall mean all taxes levied by a state on the occasion of death with respect to the transmission of property or interests therein from the dead to the living, whether such taxes be denominated as "inheritance taxes", "transfer taxes", "succession taxes", "estate taxes", "death duties", or otherwise; the word "state"

shall include any state of the United States, or any territory thereof, but shall not include the government of the United States, The District of Columbia, nor any foreign country nor any political subdivision of any foreign country; the singular shall include the plural, and the masculine shall include the feminine and neuter; "reciprocal state" shall mean any state which has in effect a law substantially similar to this act.

Sec. 2. *Notification; procedure; limitations.*

If after the death of any decedent and before the winding up and distribution of his estate, a controversy shall arise between the tax commissioner of this state and the fiduciary, or between the tax commissioner of this state and the tax commissioner of any other reciprocal state, as to the domicile of said decedent at the time of his death, the tax commissioner of this state shall forthwith notify the fiduciary by mail of the existence of such controversy and shall in such notice request the fiduciary to choose whether such controversy shall be determined by the board of arbitration hereinafter provided for, or by the ordinary processes of litigation. Such fiduciary shall, within sixty days after the receipt of such notice, inform said tax commissioner by mail of said fiduciary's choice. If the choice shall be to refer the matter to the board of arbitration hereinafter mentioned, (a) such fiduciary and the tax commissioners of all disputing reciprocal states shall thereafter be barred from litigating the question of decedent's domicile at the time of death in the courts of this state or in the courts of any other state or in the federal courts, (b) any other fiduciary of the estate of such decedent qualified under the laws of any other reciprocal state shall likewise be barred from litigating the question of decedent's domicile at the time of his death in the courts of any state or in the federal courts, (c) the tax commissioner of this state shall, upon receiving information of such choice from the fiduciary, forthwith notify by mail the tax commissioner of each other reciprocal state wherein decedent's domicile at death is claimed to have been, (d) within thirty days after the notice required in subsection (c) hereof, the tax commissioner of this state shall endeavor to come to an agreement with the tax commissioner or tax commissioners of the other reciprocal state or states involved in the dispute as to domicile, as to what three states shall furnish members of the board of arbitration hereinafter mentioned, but in case no such agreement can be arrived at within said thirty-day period, the tax commissioner of this state shall within ten days after the expiration of said thirty-day period notify by mail the tax commissioners of the three neutral reciprocal states nearest to this state, setting out (1) the name of decedent, (2) the date of decedent's death, (3) the name and address of the fiduciary, and (4) the states wherein decedent's domicile is claimed

to have been at the time of his death; and requesting said tax commissioners each to appoint within ten days thereafter one member of such board of arbitration, and the tax commissioner of this state shall, at the time of sending such notice to such tax commissioners, mail a copy thereof to the fiduciary and a copy to the tax commissioner of each state involved in the dispute and a copy thereof to the clerk of any probate court in this state which shall have granted, or shall have pending before it for granting, letters testamentary or of administration whether original or ancillary, upon the estate of said decedent.

Sec. 3. *Appointment of member of board of arbitration.*

The tax commissioner, upon the request of the tax commissioner of any other reciprocal state in the case of a dispute as to the domicile of a decedent at the time of his death, if the tax commissioner of this state makes no claim that such decedent was domiciled herein at the time of death, shall appoint one citizen of this state to be a member of the board of arbitration hereby created. Such appointee shall have no financial or professional connection with the fiduciary or with the estate itself; and such appointee shall be a member either of the bench or of the bar of this state who, in the opinion of the tax commissioner, shall be qualified by his experience to decide matters pertaining to domicile and by his character and reputation to render a just decision. The term of such appointee shall expire upon the decision by the board of arbitration of which he is a member of the domicile at death of the decedent in question. New appointments shall be made by the tax commissioner in each case within the terms of this act; a former appointee may be appointed in another case.

Sec. 4. *Compensation and expenses of appointees.*

Such appointees shall receive no compensation from this state for their services on such board of arbitration, but nothing herein shall prohibit them from receiving compensation for such services from the fiduciary, if a satisfactory amount can be mutually agreed upon between an appointee and a fiduciary; and fiduciaries are expressly authorized and empowered hereby to make such agreements for compensation, and to pay any amounts so agreed upon to any one or more of such appointees; and such amounts so paid shall be allowable expenses of administration of the estate for the purposes of any accounting in any court in this state, and such amounts so paid shall be deductible in ascertaining the net estate of such decedent (if any) subject to inheritance tax by this state. The necessary traveling and living expenses of such appointees, when the meetings of the board are not held in the towns or cities of their respective residences, shall be paid out of the appropriation of the tax commissioner of this state by the treasurer upon order of the comptroller.

Sec. 5. *Expenses of trial.*

If the tax commissioner of this state in any case within the terms of this act, shall claim that the decedent's domicile at death was within this state, necessary traveling and living expenses of witnesses who testify on behalf of the tax commissioner of this state before the board of arbitration shall be paid out of the appropriation of the tax commissioner of this state by the treasurer upon warrant of the comptroller; and the tax commissioner of this state, in any case within the terms of this act, is authorized to contract for the services of a stenographer and of expert witnesses and for all other expenses deemed by said tax commissioner necessary for the proper presentation of the case to the board of arbitration, or, alternatively, the tax commissioner of this state is authorized to agree with the tax commissioner of any other reciprocal state or states party to the dispute upon a fair proportion of such services and expenses to be paid by this state, and such sums as may be so contracted for or agreed upon shall be paid out of the appropriation of the tax commissioner of this state by the treasurer upon order of the comptroller.

Sec. 6. *Notification.*

As soon as each member of such board of arbitration is appointed, he shall forthwith send by mail notice of his appointment to the tax commissioner of this state, and the tax commissioner of this state shall within three days after receiving such notice (a) notify by mail the fiduciary and the tax commissioner of any other reciprocal state party to the dispute of the names and addresses of the members of the board of arbitration, and (b) notify by mail each member of the board of arbitration of (1) the name of decedent, (2) the date of decedent's death, (3) the name and address of the fiduciary, (4) the court or courts in this state wherein are pending proceedings for the administration of the estate of such decedent or wherein is pending litigation concerning the domicile of such decedent at the time of his death, so far as such facts are known to the tax commissioner of this state.

Sec. 7. *Powers and duties of board of arbitration; construction.*

The board of arbitration, constituted as aforesaid, shall determine, by majority vote, the domicile at death of the decedent in question, and upon reaching such determination, shall within three days send by mail notice thereof to the fiduciary, and to the tax commissioners of all reciprocal states parties to the dispute, and to any court in this state wherein are pending, proceedings for the administration of the estate of such decedent, or wherein is pending any litigation concerning the domicile of such decedent at the time of his death. Such determination by the board of arbitration shall be final and shall bind the fiduciary, the courts, and the tax commissioners of all

reciprocal states parties to the dispute. The board of arbitration, by a majority vote, shall decide upon the times and places for hearings, and shall give at least three days' notice thereof by mail to the fiduciary and to the tax commissioners of all reciprocal states parties to the dispute. The board of arbitration, by a majority vote, shall have complete discretion to make rules concerning the presentation of the case before it, including rules upon the admissibility of evidence; in determining domicile it shall follow the rules as to domicile set out in the American Law Institute's Restatement of Conflicts of law. The board of arbitration shall act upon the case before it with all reasonable dispatch; it being the intention of this act to furnish a method for the prompt determination of questions of disputed domicile for death tax purposes, to the end that fiduciaries may not be obliged to pay double death taxes with respect to the transfer of any property or interest therein; and this act shall be liberally construed to effect said purpose.

Sec. 8. *Withdrawal.*

If at any time during the pendency of a case before the board of arbitration, the tax commissioner of this state shall be satisfied that the decedent's domicile at the time of death was not within this state, he shall forthwith notify each member of the board of arbitration by mail, who shall at once notify by mail the fiduciary and the tax commissioner of each other reciprocal state involved in the dispute that the tax commissioner of this state has withdrawn his claim of domicile and has consequently withdrawn any claim of this state for death taxes against the estate of said decedent, except any death taxes which may be due to this state with respect to the transfer of any real estate or tangible personal property situated within this state. If only two reciprocal states are parties to the dispute, the board of arbitration shall thereupon determine that decedent's domicile at the time of death was within the state which has not so withdrawn its claim, and shall forthwith notify by mail the fiduciary and the tax commissioners of each disputing state; and the clerk of any court mentioned in section 6 of this act; but if more than two states are involved in the dispute, the board of arbitration shall proceed with hearings and deliberation to the determination of domicile as in other cases.

Sec. 9. *Ouster.*

The tax commissioner of this state, upon receiving notice of the fiduciary's choice in favor of arbitration as provided in section 2 hereof, shall forthwith notify by mail the clerk of any probate court in this state which shall have granted, or shall have pending before it for granting, letters testamentary or of administration, whether original or ancillary, upon the estate of said decedent; and after the receipt of such notice by said clerk, neither said probate court, nor

any other court of this state upon appeal, shall have jurisdiction to determine the domicile of said decedent at the time of death, but all such courts shall be bound by the determination of the board of arbitration, anything in the statutes of this state to the contrary notwithstanding. Any decree or order theretofore made by any such court as to the domicile of such decedent at the time of his death shall thereupon become null and void, and the clerk of such court shall make an entry to that effect upon the official record of such decree or order kept by such court. Such probate court may nevertheless, without making any finding of the domicile of said decedent at the time of death until advised thereof by said board of arbitration, proceed with the granting of letters on the estate of said decedent, and the administration thereof, except that said probate court shall make no order fixing death taxes due to this state from the estate of said decedent until after being advised of the decision by the board of arbitration of the domicile of said decedent at the time of death.

Sec. 10. *Returns; payments; interest.*

In any case falling within the provisions of this act, the provisions of the general statutes requiring the filing of returns by executors, administrators, trustees or transferees and concerning the payment of death taxes to this state shall be suspended from the date of the fiduciary's choice in favor of arbitration until the determination of the domicile of the decedent at the time of death by the board of arbitration, whereupon said provisions shall become effective again; and if by the latter date the period of time (including any extensions of time granted by said probate court) within which payment without interest of death taxes due to this state from the estate of said decedent shall have expired, interest at the rate of four per centum per annum, commencing with the date of the determination of the domicile of the decedent by the board of arbitration and running until the date of payment, shall be added to said taxes if the same are paid within sixty days after the fiduciary shall have received notice from the board of arbitration of the determination of the domicile of the decedent at the time of death, or if such taxes are paid before the expiration of any extension of time granted by said probate court upon the written application of the fiduciary filed with said court before the expiration of said sixty-day period, which extension said court is authorized to grant for good cause shown. But if said taxes are not paid within said sixty-day period, or before the expiration of such extension, as the case may be, interest at the rate of nine per centum shall be added to said taxes, commencing with the date of the determination of the domicile of the decedent at the time of death by the board of arbitration, and running until the date of payment.

Sec. 11. *Reciprocity.*

The provisions of this act shall apply only to cases in which all the states involved, whether as parties to the dispute as to domicile or as states furnishing members of the board of arbitration, shall have in effect laws substantially similar to this act.

Sec. 12. *Effective date.*

This act shall take effect upon its passage.

CHAIRMAN GIRDWOOD: Thank you, Mr. Knapp. It may be of interest to you to know that there are a few copies of the committee report available. Mr. Long, will you be kind enough to pass out the reports to the members so that we can have a discussion? There are a few high spots we can look at.

MR. KNAPP: There are also copies of a draft of a proposed reciprocal law which I hope we will have time to take up at this round table.

CHAIRMAN GIRDWOOD: It is indeed fortunate that few states have this problem of double domicile in inheritance taxation. So far as the state of Maryland is concerned, I know of no problem that we have had in the courts.

This paper calls for a discussion by three named persons. The first one is Mr. T. Ludlow Chrystie, attorney at law, of New York. Is Mr. Chrystie here? Gentlemen of the conference, Mr. Chrystie member of the New York Bar.

HENRY F. LONG (Massachusetts): Before Mr. Chrystie starts, I think it is fair to put him on the spot by saying he is acting for the commonwealth of Massachusetts in the Green case, so I want you all to look at one in whom Massachusetts puts its faith.

T. LUDLOW CHRYSTIE: Mr. Chairman, I received a very courteous letter from Mr. Farwell Knapp in which in a very discreet way he told me what to say in this discussion. I learned from that letter that I would have seven minutes. I called in a stenographer yesterday and dictated for eight minutes and I have the result here. If I can have that time, Mr. Chairman, I would like it.

CHAIRMAN GIRDWOOD: I will shut my eyes.

MR. CHRYSTIE: Of course, the temptation in this subject is to talk on all of its ramifications. But in order to do that, one would have to have many times eight minutes. For that reason, I have confined myself to a very few remarks which I have entitled, "The Legal Monstrosity of Double Domicile."

THE LEGAL MONSTROSITY OF DOUBLE DOMICILE

T. LUDLOW CHRYSTIE

Member New York Bar

I am loath to believe that this title is correct. It is true that there has appeared amongst us a monstrosity of double domicile. My deep respect for my profession tells me to protest against that monstrosity having the adjective "legal" to describe it. Every tenet of the law of domicile, ancient, medieval and modern, forbids even the thought that an individual may have two domiciles at the same time. As pointed out in many cases, he may have two, three or more residences or places in which he lives. If the individual be wealthy in this world's goods, each one of those residences may well be edifices fitting for permanent residence, but for many very important purposes affecting both property and personal rights, the law has always recognized that for the determination of those rights the law must single out and determine one place, and one place only. This place that the law so selects is called the domicile of the individual. It cannot be too sharply emphasized that domicile is synonymous with a single place. The controversies arising regarding the domicile of the individual have never been for one moment around the question of whether a man can have more than one domicile. The fact that under the law of domicile an individual can only have one domicile is the rock, the base and the absolute unchanging principle of this branch of our law. This is not just a modern concept of the law of domicile, but comes to us in a steady stream of uninterrupted logic commencing with the ancient authors and running down to the most recent case in any court.

As the abiding principle of domicile is as above indicated, one naturally might wonder why the National Tax Association has constituted a committee on double domicile in inheritance taxation. Not only has it such a committee, but we have just heard read the third annual report in which the committee states: "It seems to your committee that it is not yet possible for it to make any recommendations." It is evident from the present report of the committee and also from the report rendered last year at Indianapolis, and from the initial report and made in the previous year at Oklahoma City, that this association is under a great debt to Mr. Farwell Knapp and his fellow committeemen for the scholarly reports which they have made. I, personally, have nothing but praise for the work which this committee has done during the past two years and I want this fact to stand out at the beginning of my short discussion of the general subject.

It is against the fundamental principles of the law that an individual can have two domiciles, but in spite of that fact, our system of jurisprudence is so faulty that it has permitted the monstrosity of double domicile to raise its head. In the limited time allotted for my

discussion it is not possible to deal in detail with the problem. There are, however, two main reasons why the problem exists. Unless we face these two reasons squarely, it may be that the committee is accurate in saying that "It is within the bounds of possibility that the central problem is insoluble in a practical sense."

The first reason is that each state is jealous of its so-called right to determine in its own particular courts matters of domicile affecting individuals whom its officers claim are domiciled within the given state. So far as I know there are only three cases in which a state has gone into the courts of another state and submitted itself to the jurisdiction of the courts of the other state for the purpose of having tried out the question of domicile.¹ I can very well understand the theory upon which each state takes this position, but nevertheless I think the feeling is archaic and is directly opposed to the present realities of the question. I think the domicile of an individual is not now purely a state matter, but that domicile has in our country an importance so great that in reality it is a national question. If this is so, as I earnestly contend it is, then the question of which state an individual is domiciled in should be decided in a federal court, but my friends will urge that that is not now possible. I am not so sure of that, but if it is not now possible it certainly could be made possible, if all the states desire it. In other words, once remove each state from what seems to me to be a petty platform and elevate it to the higher plane of regarding the question as a national problem, then we arrive at the second question which stands in the way.

This second question relates to whether the federal courts now have jurisdiction to try cases of disputed domicile and if they have, whether their process will run so as to bring within the forum of the particular federal court all the necessary parties. I think that if our present laws are so impotent that an important question like conflicting claims of domicile cannot be tried out in one tribunal, then our laws should be amended.

If we throw up our hands and say that it is not possible to have adjudicated in a competent court having power to issue process sufficiently wide to bring in all the interested parties, then inevitably we must change our concept, centuries old, of domicile. No longer will the law be that a man can have only one domicile, but the law will be that he can have as many domiciles as there are different state courts which undertake to try out the question. This is the condition which exists today and it is a shocking condition. If the concept of domicile is thus changed so that a man can have domiciles in every state where a state court has adjudicated the question, then what becomes of the decision of the United States Supreme Court

¹ *Matter of Lydig*, 191 App. Div. 117, 180 N. Y. Supp. 843; *Matter of Stone*, 135 Misc. 736, 240 N. Y. Supp. 398; *Matter of Trowbridge*, 266 N. Y. 283, 194 N. E. 757.

that only the state of domicile has the power to tax the transfer of intangibles in a death tax case?² Necessarily this doctrine laid down by the United States Supreme Court must disappear if this new concept of domicile persists. Can it not be fairly said that if the United States Supreme Court's decision is meaningless and an individual can have any number of domiciles, limited only by the number of states that try out the question independently, the law of domicile is thereby plunged into an unthinkable chaos of confusion?

Virgil's *Monstrum Horrendum* was no more misshapen and terrifying than *Monstrum Horrendum* of double domicile.

I respectfully submit that the only satisfactory solution of the problem is that there shall be in our country a court in which disputed cases of domicile shall be tried out and whose jurisdiction shall be sufficiently broad to bind all persons properly interested in the question.

CHAIRMAN GIRDWOOD: Thank you, Mr. Chrystie.

There may be some distinction as between these invited participants and the voluntary speakers. Am I to interpret that they are entitled to ten minutes or seven minutes?

SECRETARY W. G. QUERY: Seven minutes.

CHAIRMAN GIRDWOOD: The next person scheduled to discuss the report is Mr. William A. Schnader, member of the Pennsylvania Bar. Mr. Schnader! It is very refreshing to have these lawyers here.

WILLIAM A. SCHNADER (Pennsylvania): Mr. President, Gentlemen of the Conference: Unlike Mr. Chrystie, I did not come with my remarks prepared and fitted into the seven-minute groove which the rules of the conference permit.

I suppose Mr. Knapp invited me to come here today more or less as one of the exhibits in the celebrated Dorrance cases. During one phase of that litigation I happened to be attorney-general of Pennsylvania and before the litigation was over, and after I had ceased to be attorney-general of Pennsylvania, I represented the Dorrance estate in the final stages of the New Jersey litigation.

Those cases illustrate beautifully the difference between theory and fact. In theory of course a man can have but one domicile but, in cold hard fact, Dr. John T. Dorrance had two domiciles because his estate paid \$17,000,000 to the commonwealth of Pennsylvania and substantially that sum to the state of New Jersey.

I don't have time in the short period allotted me to go over with you the various interesting steps in that litigation. If you are interested, I hope you will forgive me for referring you to the May issue

² First National Bank of Boston v. Maine, 284 U. S. 312; Beidler v. South Carolina Tax Commission, 282 U. S. 1; Baldwin v. Missouri, 281 U. S. 586; Farmers Loan & Trust Co. v. Minnesota, 280 U. S. 204.

of the Tax Magazine in which you will find a historical statement of that litigation which I prepared for the committee on taxation of the American Bar Association last spring.

There are just one or two interesting things that I should like to point out in connection with a discussion of the third report of your committee. First of all, the facts upon which the courts of Pennsylvania and of New Jersey reached opposite conclusions were identical.

In Pennsylvania there was litigation between the Dorrence estates and the commonwealth to determine the domicile of Dr. Dorrence. After the supreme court of Pennsylvania decided that Dr. Dorrence was domiciled in Pennsylvania the estate offered the complete Pennsylvania record before the tax commissioner of New Jersey, and that was all the evidence which there was in the case. So that when, first, the prerogative court of New Jersey, and then the supreme court of New Jersey, and then the court of errors and appeals determined that Dr. Dorrence was domiciled in New Jersey, they did it on precisely the same facts as did the courts of Pennsylvania when those courts decided that he was domiciled in Pennsylvania.

I differ with your committee in the statement that the law of domicile is uniform, with minor exceptions, unless perchance it is minor that the law of Pennsylvania and the law of New Jersey are far from uniform as far as concerns the rules which apply.

In Pennsylvania our court took the position that the matter of primary importance is the place which was the decedent's home, that the important thing in the case is his intention to make a place his home, and that of entirely minor importance is his intention as to where his domicile shall be.

In New Jersey the courts took the position that beginning with the fact that the decedent was at one time domiciled in New Jersey, if he kept his property there, and if he did not have an intention to abandon New Jersey as his domicile, then he was still domiciled in New Jersey.

I thoroughly agree with Mr. Knapp's suggestion in his proposed draft of reciprocal legislation that such legislation must at least do what he proposes here and say, in applying a scheme of arbitration such as he is suggesting, the rules of law as promulgated by the American Law Institute shall be the rules which shall be applied by the system of arbitration which he proposes.

Now let me come to this suggestion of compacts between states or reciprocal legislation. It seems to me, Mr. Chairman, that the idea is splendid but that there are certain practical objections to it, which make it far from a sure cure for the horrible picture which Mr. Chrystie has very properly painted for you.

In the first place, if the federal constitution makes it clear that only one state has a right under that constitution to impose an inheritance tax, can two or more states by compact or by reciprocal

legislation compel those in charge of any estate to submit to a decision by any tribunal which falls short of the possibility of an appeal to the highest court of the land to determine whether any state has imposed an unconstitutional inheritance tax levy?

It seems to me that that is a fundamental question which must be met in any proposal for a compact system or for reciprocal legislation.

I contend that two or more states can agree that, as far as they are concerned, a scheme such as that which is proposed by Mr. Knapp's committee shall be final, but I question whether it is possible for the states by compact or by reciprocal legislation to compel any estate to submit to that type of determination of the question.

Of course, in most cases it would probably be to the advantage of the estate to submit. But there are cases where it might conceivably be substantially to their disadvantage not to preserve their right to have the highest court of the land say where the decedent was domiciled.

What is the answer? It seems to me that the most desirable answer would be to have the supreme court of the United States reverse the circuit court of appeals of the first circuit in the Hunt case. Were that to be done, I take the view that when the taxing officials of two or more states enter an interpleader, they enter that interpleader in the same capacity in which they could be sued in a federal court, namely, as persons who are threatening to impose an unconstitutional levy on an estate, unconstitutional because the decedent was not domiciled in one or the other of the states which enter the interpleader. I say if that can be done then we have a method by which in one proceeding we can have a determination of this question which clearly will be final and binding on all concerned.

If that cannot be done, I agree with your committee that something along the lines of reciprocal legislation should be attempted and worked out if possible.

I agree that litigation in the federal courts—separate litigation against the taxing officials of various states in separate proceedings—is not the solution of the problem. I am clearly of the opinion that the federal courts do have jurisdiction to entertain a suit by an estate against the taxing official where the estate claims that the taxing official is undertaking unconstitutionally to impose a death tax.

Of course, that litigation must begin at the right time. It must not begin until the administrative procedure of the state has been exhausted, and it dare not begin after the proceedings have passed from the administrative to the judicial stage.

In the Dorrance cases we made an attempt to get into the federal courts in the New Jersey case but that was not done until after the case had proceeded to the judicial stage, and for that reason, and only for that reason, the supreme court of the United States sustained the district court in saying that we had come into the federal

court too late. But in the Dorrance case, for example, suppose the estate had begun by suing the Pennsylvania taxing officials in the federal court to restrain them from collecting. New Jersey would not have been a party to those proceedings. It could very well have taken the position that it was not bound by those proceedings. Conceivably, the evidence in that case and in the case subsequently brought by the estate against the taxing officials of New Jersey might have been quite different. It was possible in that case to have produced evidence differing radically from the evidence which was embodied in the Pennsylvania record, for the reason that in Pennsylvania the estate was undertaking to prove that the decedent was domiciled in New Jersey, and they had a mass of proof which could have been used upon a different theory to show that the decedent was domiciled in Pennsylvania.

You could have two cases in two district courts in which the evidence would not be the same, in which each state could take the position that it was not bound by the outcome of the other case.

Of course, that is a very unhappy situation and one which does not solve the problem. Before I sum up, let me say that in the Dorrance cases, at one stage or another, practically everything was attempted which has ever been thought of except proceedings under the interpleader act and that couldn't be done because the interpleader act wasn't passed in time. New Jersey tried to file a bill in equity against Pennsylvania in the supreme court of the United States but leave to file the bill was refused, no doubt because, as your chairman suggested in his report, that court is going to take the position that there must be unusual circumstances in order to sustain the position that a state as such has an interest in this question which entitles it to go into the supreme court of the United States, original jurisdiction, and file a bill against another state.

As I say, practically everything that has yet been thought of appeared in some stage of that litigation.

It seems to me that your committee is absolutely correct in taking the position that it wants to wait until it sees what the supreme court of the United States will do in the Hunt case. It is too early to make a recommendation. Should the supreme court hold that the interpleader act is applicable, it is my individual opinion that that will prove to be the best solution which anybody could find. Should the supreme court not so hold, then it seems to me that something along the lines of reciprocal legislation ought to be attempted, but in doing so a modification of the first tentative draft will have to be made under which the fiduciaries, the executors of an estate, will have to become parties to a binding agreement, perhaps with the approval of the court in which the estate is being administered, so that once you have gone through with the type of procedure which Mr. Knapp so ably suggests, the estate will be bound and cannot then say that it still wants to go on and try out its case in the federal courts and get a determination of that sort.

CHAIRMAN GIRDWOOD: The next scheduled speaker on this program is Mr. Gentry, inheritance tax attorney for the state of California. I think he is here by virtue of the Hunt case and the interpleader act of the United States.

W. H. H. GENTRY (California): Mr. Chairman and Members of the Conference: I think possibly at this late hour it might be well to have some understanding of the time, before I begin my paper. I prepared the paper on the understanding, not knowing the laws of your conference, that I would have 20 minutes. If you don't want to listen for twenty minutes, we can decide that beforehand.

CHAIRMAN GIRDWOOD: You had better read the first part, then. You have seven minutes under the rule. At the end of seven minutes, the time may be extended by request of the conference itself.

HENRY F. LONG (Massachusetts): Because Mr. Gentry is on the other side of the Hunt case from me, I hope as a matter of confidence in Massachusetts and as a matter of courtesy to California the time will be extended to the time Mr. Gentry will need to make his presentation. I so move.

CHAIRMAN GIRDWOOD: You have heard the motion by Mr. Long that the time be extended. What is your pleasure?

All those in favor signify by say, Aye.

(Ayes)

Those opposed?

(None)

The motion is carried.

W. H. H. GENTRY: Before I had been appointed a member of the committee on double domicile, in inheritance taxation, I received an invitation from the chairman of the committee to discuss the subject following the report of the committee.

Under ordinary circumstances, as a new comer in these conferences, I would probably have declined the invitation. Instead of doing so, however, I considered the circumstances and concluded that the invitation had probably been extended because of my official position as inheritance tax attorney of California, I was made a party respondent in the interpleader suit of *Worcester County Trust Company, Executor v. Riley, et al.*, commenced in the United States District Court at Boston to determine the domicile of Robert H. Hunt, deceased, at the time of his death, and consequently the state entitled to the inheritance tax on his intangibles, and was by the other California respondents handed the responsibility of defending the suit. It therefore became absolutely necessary for me to familiarize myself with the law involved in the matter, and I have made

a careful study of the question. I chose to believe, therefore, that in extending this invitation to me the committee was recognizing the fact that California had been thrust to the front in litigation involving the problem before the committee and was therefore entitled to be heard on the question, and also the further fact that I should have some pretty positive ideas on the question based on close study. I therefore felt warranted in accepting the committee's invitation.

Of course anyone in thinking of this question immediately thinks of *Worcester County Trust Company, Executor v. Riley, et al.*, supra. This was the first case of its kind brought under the new federal interpleader act. That complainant must have been waiting for that act is indicated by the fact that it became law on January 20th, 1936, and the bill of complaint was filed in February.

The report of the committee says in substance that present litigation may result in a solution of the question of double domicile in inheritance taxation through the courts. What that means is that if the supreme court upholds the jurisdiction of the district court in *Worcester County Trust Company, Executor v. Riley, et al.*, a solution will have been found. I acquiesced in that report, but with no intention of intimating that I thought for one moment that such a solution would not prove very unsatisfactory to the great majority of the states.

On account of the importance to all jurisdictions of the outcome of this case, and the fact that California has been vigorously contesting the jurisdiction of the federal courts in the matter for over a year and a half, I feel justified in addressing most of my remarks to that case.

The suit purported to be one by the executor of the estate to interplead officials of Massachusetts and California as to the inheritance taxes payable in the matter, the one state or the other to be awarded the inheritance taxes on the intangibles depending on the domicile of decedent in the one state or the other at the date of his death, and the officials of the other state to be permanently enjoined.

The new interpleader act does not in its language, purport to deal with other than proper interpleader suits or suits in the nature of interpleader. In fact, it in words, provides for a suit brought by one who has ". . . in his or its custody or possession money or property of the value of \$500 or more . . ." or ". . . is under an obligation written or unwritten to the amount of \$500 or more . . ." if ". . . two or more adverse claimants, citizens of different states . . . are claiming to be entitled to such money or property" or to the benefit arising out of such obligation.

It further provides that the "court shall hear and determine the cause and shall discharge the complainant from further liability. . ."

In view of the opinion of the district court and the dissenting opinion in the circuit court of appeals, we emphasize this provision that the "court shall hear and determine the cause and shall discharge the complainant from further liability."

California maintains that as the sole purpose of interpleader is to enable the plaintiff by one suit and judgment to be discharged of an obligation, and to bring before the court the several parties who *claim to be entitled* to that obligation, it follows that the bill must name as respondents each party who would *be entitled* to that obligation if his or its contention prevailed.

In this case the principal issue sought to be raised by the executor by its interpleader bill is the issue of fact as to the decedent's domicile. If the domicile was in California, the state of California is entitled to the tax obligation with respect to the intangible personal property. If the domicile was in Massachusetts, that state is entitled to that obligation. Obviously, then, the executor must interplead the two states in order to enable the court to discharge it from all further liability for its obligation.

Under the eleventh amendment to the constitution of the United States, a state can not be sued by a citizen of another state in a federal court. Complainant, recognizing this fact, named as respondents certain officials of the two states and argues that they are being sued in their individual capacities and not as officials. The question then is, how can the complainant be discharged of its obligation to California and Massachusetts in a suit against parties other than those states, namely, officials of those states, not as officials but in their individual capacities? This difficulty was recognized in the opinion of the district court and the dissenting opinion in the circuit court of appeals. The judge of the district court admitted in his opinion that he could not fix the tax due either of the states but held that he could decide the question of domicile and remand the matter to the states with instructions. In the dissenting opinion in the circuit court of appeals it was stated that when the court determines the state of decedent's domicile the action will be dismissed as to the designated officials of that state. As stated above, the interpleader act provides for no such proceeding but for a determination of the matter and discharge of "the complainant from further liability."

If the supreme court upholds the jurisdiction of the district court in this matter then in my judgment, the eleventh amendment, as far as inheritance taxation is concerned, becomes a mere scrap of paper. And of course the law as decided will apply also to state income taxes and ordinary state and municipal taxes on intangibles.

Very early in our national history (February 18, 1793) the supreme court of the United States in *Chisholm v. Georgia*, 2 Dallas' 419, decided that under the constitution a state could be sued in that court by citizens of another state. In *Hans v. Louisiana*, 134 U. S. 1, the supreme court of the United States in speaking of the opinion in *Chisholm v. Georgia*, said it "created such a shock of surprise throughout the country that at the first meeting of congress thereafter, the eleventh amendment to the constitution, was almost

unanimously proposed, and was in due course adopted by the legislatures of the states. This amendment, expressing the will of the ultimate sovereignty of the whole country, superior to all legislatures and all courts, actually reversed the decision of the supreme court. It did not, in terms, prohibit suits by individuals against the states, but declared that the constitution should not be construed to import any power to authorize the bringing of such suits. The language of the amendment is that 'the judicial power of the United States shall *not be construed to extend* to any suit in law or equity, commenced or prosecuted against one of the United States by citizens of another state or by citizens or subjects of any foreign state. The supreme court had construed the judicial power as extending to such a suit, and its decision was thus overruled. . . .

This view of the force and meaning of the amendment is important. It shows that, on this question of the suability of the states by individuals, the highest authority of the country was in accord rather with the minority than with the majority of the court in the decision of the case in *Chisholm v. Georgia*. . . ."

It is that same eleventh amendment adopted almost a century and a half ago that is being put to the test in this proceeding. If the supreme court decides that the amendment can be practically annulled by the ruse of making the officials of the states nominal parties instead of the states, then it would not surprise us to see the "highest authority of this country" again rise up and overrule the supreme court by another amendment providing against such an emasculation of the eleventh amendment.

In saying this we are not unmindful of the fact that the taxing authority of Massachusetts has taken an entirely different attitude in this matter supported by the taxing authority of Connecticut in the district court in a brief amicus curiae, in support of complainant. Massachusetts refused to join in our motion to dismiss for lack of jurisdiction, or in our appeal. She has done everything possible to aid and abet the complainant in maintaining the suit on the ground that she does not wish to be a party to double taxation. We can not but wonder if her attitude would have been the same if this suit had been filed in the United States District Court in Los Angeles, California. In other words, is her attitude unconsciously influenced by the fact that if this suit prevails California will be at the distinct disadvantage of being compelled to try the question of domicile in a federal court at the home of complainant (who we submit is not a disinterested complainant but who is endeavoring to maintain the domicile in Massachusetts) and three thousand miles from California and her witnesses. Is she willing, in other words, to have a decision made which may well rise up to plague her and all other jurisdictions in the future for the advantage she may gain in the instant matter? If so, her action is not without ancient well-publicized precedent, for we read in Holy Writ that Esau was induced to sell his birthright for a mess of pottage.

In this connection it is interesting to note in the estate of Edward H. R. Green, deceased, that in the suit in the United States Supreme Court by the *State of Texas v. State of Massachusetts, et al.*, to determine the domicile of decedent and consequently the state in which his intangibles are taxable notwithstanding the danger of multiple (not double but multiple) taxation of those intangibles, Massachusetts, in her answer, denied the court's jurisdiction.

The foregoing remarks apply alike to all jurisdictions. There is another feature which we think should decide this suit, which applies to few, if any, jurisdictions other than California. We are told by the U. S. Supreme Court in *Ex Parte Young*, 209 U. S. 123 at 163, "It is proper to add that the right to enjoin an individual, even though a state official, from commencing suits under circumstances already stated, does not include the power to restrain a court from acting in any case brought before it, either of a civil or criminal nature, nor does it include power to prevent an investigation or action by a grand jury. The latter body is part of the machinery of a criminal court, and an injunction against a state court would be a violation of the whole scheme of our government. If an injunction against an individual is disobeyed and he commences proceedings before a grand jury or in a court, such disobedience is personal only, and the court or jury can proceed without incurring any penalty on that account.

The difference between the power to enjoin an individual from doing certain things, and the power to enjoin courts from proceeding in their own way to exercise jurisdiction is plain, and no power to do the latter exists because of a power to do the former."

We understand that in most jurisdictions there is an administrative official who fixes and collects the inheritance tax in the absence of an appeal to the courts. We understand also that in New York where the pro forma order fixing tax is made by the surrogate, under the decisions of the New York courts, the surrogate in making said pro forma order acts in an administrative capacity only and if there is an appeal from the pro forma order it is to the surrogate himself who then, for the first time, acts in a judicial capacity.

Also in Missouri, where we understand the court may act with or without an appraiser, if an appraiser is appointed and exceptions are taken to the appraised values they are "determined by the court in a summary manner" and the tax fixed.

Under the decisions of the Missouri courts the judge in so doing is acting as an administrative official and not judicially.

We believe the situation is entirely different in California. No inheritance tax can be collected in California except on the judgment of the superior court fixing the tax and the taxpayer has all the rights provided in the code of civil procedure for any judgment debtor regarding appeals, etc., before the judgment can become final. In every probate proceeding whether there is an inheritance

tax or not, as one step in the proceeding, the court, on its own initiative, must fix the inheritance tax, if any, or make an order that none is payable before there can be any distribution of the estate. The judge of the court, however, can not alone make said order or finding. He must, in every such proceeding appoint an inheritance tax appraiser who, under the inheritance tax act, has all the powers of a referee, and the referee must file his report with computations of the inheritance tax payable, if any, and by whom. No order can be made confirming the report and fixing the tax until ten days thereafter and notice to all interested parties has been given. Until the order is made, any interested party may file objections to the report and the judge must try the objections. If no objections to the report are filed the order fixing tax may be made without further trial. The order fixing tax is a judgment. *Estate of Brown*, 196 Cal. 114; *Kelshaw v. Superior Court*, 137 Cal. App. 189; *Estate of Edwards*, 138 Cal. App. 162.

The services of the inheritance tax appraiser can not be dispensed with in any case. *Estate of Haskins*, 170 Cal. 267. The referee can not, in any case, render a judgment. On the other hand the judge can not in any case render a judgment without the preliminary report of the referee. Both are absolutely indispensable parts of the machinery of the probate court in every inheritance tax matter, so that under the law of *Ex Parte Young*, supra, to enjoin the appraiser is to enjoin the court, and as said in that case "an injunction against a state court would be a violation of the whole scheme of our government." Of course the federal courts will accept the state court's construction of the state law.

In the *Estate of Will E. Keller*, suit was brought by the executors against state officials in the United States District Court for the Southern District of California (Central Division) in Equity, Number 747-J, alleging non-residence of the decedent and that the officials were acting unconstitutionally in attempting to collect the California inheritance tax on the basis of a California domicile and praying for an injunction. The suit was dismissed by a three judge court January 25th, 1936, on the ground that the entire inheritance tax proceeding in California is a proceeding in court and therefore could not, under the statute involved therein, be stayed by injunction.

We submit that it is not only a proceeding in court, but just as clearly a proceeding by the court, begun by the appointment of the inheritance tax appraiser as referee of the court. This was recognized by the district court in the instant matter but he said in the opinion that the statute gave him the right to enjoin the state court. We have then three California respondents, the appraiser who is a part of the court and therefore can not be enjoined, the controller who can take no action of any kind until after the appraiser files his report, and the inheritance tax attorney who is simply the legal adviser of the controller. None of the respondents can begin or

dismiss any proceeding in probate to fix the inheritance tax. It is really immaterial whether the controller and inheritance tax attorney are enjoined or not, as they can do nothing in the matter anyhow.

Assuming, therefore, that the supreme court will uphold the majority opinion of the circuit court of appeals, then what? Personally, I believe the dangers of inheritance taxes being imposed by two or more jurisdictions in the same estate have been greatly exaggerated. We believe it is not necessary in order to afford reasonable relief to the taxpayer to compel state taxing authorities to run from one end of the country to the other enforcing their tax statutes in federal courts or otherwise. We believe a far better relief can be afforded to the taxpayer by the various states by the adoption of uniform rules for determining domicile and in insistence that their officials act with open minds and fairly in particular matters that may arise.

We believe that Connecticut succeeded in the New York Court of Appeals in *In re Trowbridge's Estate*, 194 N. E. 756, in securing a clean-cut ruling on what should be the law of domicile in every jurisdiction. If we understand that decision, it means that you can not move from one state to another, with the intention of living there permanently and yet retain a domicile in the former state.

Of course if a person has two dwellings in different places and resides a part of his time in one place and a part of the time in the other, the question, which of the two places is his legal residence is almost altogether a question of intent. We believe, however, a sound corollary to this rule is found in 9 Cal. Jur. 836. It reads: "But a floating intention to return to a state by one who had taken a residence for an indefinite period in another state would not be sufficient to retain his domicile in the former." In support of this rule is cited *Bullis v. Staniford*, 178 Cal. 40, 171 Pac. 1064, and *Estate of Weed*, 120 Cal. 634, 53 Pac. 30.

We believe a large part of the difficulties which have arisen are due to the fact that most of us have been overemphasizing the intent to have a domicile at a particular place and somewhat overlooking the fact that there must be a residence to back up that intent. It took a case like *In re Trowbridge's Estate* to bring us to a realization of that fact. In other words, this case did not change the almost universally recognized law of domicile. It simply set forth clearly an essential requisite of domicile, namely, permanent or indefinite residence. If property owners and executors will recognize the law of this case and act accordingly, we believe ninety percent of the dangers of double taxation will vanish. If the property owners and executors of their estates, refuse to cooperate then I fail to see why we should waste much sympathy on them. Of course there will remain some cases of bona fide doubtful domicile. These, in our judgment, might well be taken care of by the taxing officials of the various states being given power to compromise the taxes in

such cases and using that power liberally in favor of the taxpayer so that hardships may be avoided and each state get a fair proportion of the tax. In this connection I may state that scarcely a week goes by that some questions of disputed domicile are not presented to us in California. They are promptly given fair consideration and we do not now recall any case, except the Hunt case, in which the matter has not been settled to the seeming satisfaction of all concerned. In the great bulk of them if the other states concerned have acted in the same spirit as California, the taxpayer has not been injured. Whether the same spirit has actuated the other states or not, of course we do not know. It would seem, however, that California has built up a reputation for compromising these matters as I note in the letter of Mr. Knapp asking me to make these remarks the statement that California "has apparently been the leading state in compromising such questions." Of course all compromises suggested by the controller must be approved by the court and incorporated in the order fixing tax before becoming effective.

We might add also that California has probably been much more liberal in compromising such matters than she will be in the future. We believe the property owners, and executors, should be given fair warning and then only cases of real bona fide doubt as to domicile compromised. That is all that is necessary to protect the taxpayer from double taxation.

We might say, in concluding, that we were given no opportunity to consider a compromise in the Hunt matter until after we were haled into the federal court. We can not, of course, compromise the question of jurisdiction of the federal court and none of the California respondents has any right to consent to the maintenance of the suit.

As hereinbefore indicated, California is doing everything in her power to defeat the jurisdiction of the federal court in *Worcester County Trust Company, Executor v. Riley, et al.* She has employed able counsel in Boston who have, in our judgment, handled the matter in all of the courts excellently. Assistance has been received from the taxing authorities of many other states. If, notwithstanding all this, the decision of the supreme court should be adverse, we trust the other states affected thereby will not feel that the decision is due to any lack of diligence on the part of California.

CHAIRMAN GIRDWOOD: That disposes of the scheduled discussers. Both papers are now open for general discussion.

BRUCE P. TYLER (Virginia): My good friend, Dr. Snavely, has given me permission to add an item to his paper.

In the state of Virginia the county and the city are the assessing units upon all items of real estate, and real estate is divided into two classes: mineral lands and non-mineral lands.

Dr. Snavelly's remarks applied only to the non-mineral lands, the assessment of which is in the hands of the board of supervisors. The mineral lands within the county are assessed annually by the commissioner of revenue, subject to revision by the judge of the circuit court. There is a distinct difference in the method of handling the assessments of mineral lands and non-mineral lands in the state of Virginia.

Another item that might be of interest is the assessment of machinery and tools. The taxation on machinery and tools is segregated to the counties or the cities in which the property is located and the amount of the assessment cannot exceed the assessment on tangible personal property, but it can be as low as the assessing authorities wish to make it. Hence throughout the state there is some competition for industrial improvements, the tax on machinery and tools varying as much as from 20 cents on \$100 valuation to practically \$4.00 on the assessed valuation.

I just wish to add that to the remarks of Dr. Snavelly, particularly the item of the method of assessing mineral and non-mineral lands, which I think should be differentiated.

CHAIRMAN GIRDWOOD: Thank you.

SETH T. COLE (New York): Mr. Chairman and Gentlemen of the Conference: When Mr. Chrystie commenced his remarks I thought that he was going to sum up the Green case for Massachusetts and that it would be necessary for me to take up the battle and sum up in the same case for New York, but I find that he very carefully avoided doing that, so that it is not necessary for me to do anything in that regard either.

I was very much interested in the discussion of the report of the committee. I am sure that it has been very helpful not only to the conference but also to the members of the committee, in the event the association sees fit to continue it for another year.

Mr. Schnader pointed out that in all probability an executor or administrator could not be forced to abide by an arbitration under a reciprocal statute, and could not be deprived of his right to take a constitutional question involved in a domicile case to the United States Supreme Court. With that thought I am wholly in accord. The representative cannot be deprived of his constitutional rights against his will. But as I read the draft of the proposed reciprocal law, it does not seem to me that that result is brought about by this proposed statute.

Section 2 provides that if after the death of any decedent and before the winding up and distribution of his estate a controversy shall arise between the tax commissioner of this state and the fiduciary, or between the tax commissioner of this state and the tax commissioner of any other reciprocal state as to the domicile of said decedent at the time of his death, the tax commissioner of this state

shall forthwith notify the fiduciary by mail of the existence of such controversy, and shall in such notice request the fiduciary to choose whether such controversy shall be determined by the board of arbitration hereinafter provided for or by the ordinary processes of litigation. Such fiduciary shall within sixty days after the receipt of such notice inform said tax commissioner by mail of said fiduciary's choice. If the choice shall be to refer the matter to the board of arbitration hereinafter mentioned, such fiduciary and the tax commissioner avow disputing reciprocal states shall therefore be barred from litigating the question of decedent's domicile at the time of his death in the courts of this state or in the courts of any other state or in the federal courts.

So it seems to me that under this reciprocal statute as it is drafted, it is a matter of election for the fiduciary or representative to determine whether he wishes to submit to arbitration, and if he does elect to submit his case to arbitration then it seems to me that he would be bound by the terms of the act.

I notice that the last thing on the program today is the report of the committee on resolutions which will not be acted on today but will be referred to the meeting tonight so at the end of the discussion please see that we have time for the report of the committee on resolutions, Judge Leser.

PRESIDENT LESER: I shall be very pleased to.

There was a remark made by Mr. Gentry that recalled a very interesting incident to me which occurred at the time when I was on the appeal tax court, which is the taxing body of the city of Baltimore.

We had a statute enacted in 1896 which put a tax on the resident beneficiary. It subjected the resident beneficiary to a property tax on securities held by a non-resident trustee. Since that time the case of Safe Deposit Company against Virginia, and a long line of other decisions have declared that there could be no such property tax validly imposed except at the situs of the trustee's residence. However, that was the law at that time and in that shape it was administered in Maryland for twenty years at least, without anyone ever raising the point that was finally raised in the Safe Deposit case.

I remember an occasion when a notice of that kind was sent to a beneficiary. He came in in high dudgeon and said the trustee was the Harrisburg Trust Company. He also said, "They are taxed on those same securities in Harrisburg. What right have you here in Maryland to tax them over again?"

I said, "I agree with you it is an outrageous thing that there should be a double tax on the same property and if you will take my advice you will take the first train to Harrisburg and give them hell."

Another thing I wanted to ask General Schnader was what the value of the property of the Dorrance estate in New Jersey is, roughly.

MR. SCHNADER: The estate was about \$105,000,000, Judge.

PRESIDENT LESER: No, in New Jersey.

MR. SCHNADER: Well, all of it was in New Jersey except about \$2,000,000 of Pennsylvania stock.

MR. LONG: Didn't he have some real estate in Pennsylvania?

MR. SCHNADER: No, that was held by the doctor and his wife as tenants for life.

PRESIDENT LESER: That being so, why did the estate submit to the jurisdiction of Pennsylvania and allow Pennsylvania to take all the property that was there, when they could have gotten off with \$2,000,000, instead of \$17,000,000?

MR. SCHNADER: What happened, Judge, if you are interested, was that the state put an ex parte assessment on the books, and the Dorrance estate took an appeal, thus submitting itself to the jurisdiction of the Pennsylvania court. Then after the supreme court of Pennsylvania rendered its decision, in order to apply for a right of certiorari to the supreme court of the United States it became necessary for the estate to file a bond in the amount of, I think, \$15,000,000. So that at that stage the commonwealth of Pennsylvania was assured of its collection in the event that the decision of the supreme court of Pennsylvania was not disturbed.

PRESIDENT LESER: Isn't it a fact that if they hadn't submitted to the jurisdiction they would have gotten off with \$2,000,000?

MR. SCHNADER: That was my view at the time.

May I say one more word?

I just want to say in answer to Mr. Cole that I was not criticizing the draft of this reciprocal bill. What I meant to say, and all I meant to say was that you didn't have a complete solution because it lay within the choice of the executor-administrator whether he would come in or not, and I want to say also that I am in accord with what Mr. Gentry said as to the desirability in many cases of compromising these matters.

During my term of office we had four conferences, one between Pennsylvania and Maine that involved a tax of \$2,000,000. Each of us took \$1,000,000 and called it a day. The second was between Oklahoma and Pennsylvania. That was compromised on a basis satisfactory to both states. The third was between New York and Pennsylvania, in which case I know Mr. Cole will not object to having me compliment him upon being convinced that New York

should withdraw its claim. But when you have a tax claim of 16 or 17 million dollars, then you are practically out of the field where compromise is possible.

The most uncomfortable day I had in the Dorrance case—and I was handling it for the commonwealth—was the day I heard a settlement proposition was going to be submitted to me, because any public official would hesitate tremendously to assume the responsibility either for rejecting a settlement or for accepting it. Had I said, "No," refused the settlement, and lost the case, my professional reputation would have been mud. On the other hand, had I accepted a settlement, whatever it may have been, thus depriving the commonwealth of the possibility of getting 8 or 9 million dollars, there would have been a debate raging no doubt in Pennsylvania for months as to whether or not the attorney-general of Pennsylvania was too yellow to go on with the case.

It is in that field, where you have these big tax claims, that it seems to me your committee's efforts are very much worthwhile in trying to find a solution.

PRESIDENT LESER: General, do you think if you had accepted the compromise it would have made any difference in the result of the late gubernatorial election in Pennsylvania?

MR. SCHNADER: Well, the majority the other way might have been multiplied—that is all.

CHAIRMAN GIRDWOOD: Time is getting short, gentlemen. I promised Mr. Knapp a few moments to explain the draft of the proposed reciprocal law reported by the committee, but if there is one man who should be heard on this report it is Mr. Long. If I remember correctly I saw in the record where he intervened in the supreme court of the United States in the case of Reilly versus Worcester Trust Company. The case involves Massachusetts, and I think the conference ought to hear from him.

MR. LONG: That is very generous of you, Mr. President, and I am very grateful to all who are willing to listen but I think, as a matter of fact, that I would rather rest my case entirely in the hands of Mr. Knapp and therefore I will give my allotted time to him.

CHAIRMAN GIRDWOOD: Before Mr. Knapp talks on the proposed draft of the bill, is there any further discussion? Does anyone want to be heard on the bill? Mr. Knapp requests five minutes to explain the purpose and draft of the proposed reciprocal law.

PRESIDENT LESER: I move his time be extended to six minutes.

FARWELL KNAPP: Mr. Chairman, those who are left here are the die-hards and if you don't put your foot down this will go on all evening and well into the night, because I know a great many people here and I know how interested they can get in this subject.

I do think however that perhaps I should explain very briefly the idea of this draft of the proposed reciprocal law. Printed copies of it are available. Mr. Cole has read section 2 or a good part of it and I don't think I need take much of your time. This draft was done rather hastily and I am pretty sure it is full of holes, but I asked the secretary to have it printed so that people who are interested could study it, and I hope after studying it you will send me your suggestions, if the committee is continued.

The idea is, of course, to set up a board of arbitration. After the executor has made his choice, the tax commissioners of the disputing states are to try to get together to pick a board of arbitration, but if they cannot then the three nearest reciprocal states are to be requested each to appoint one member of the board, that is, their tax commissioners are to appoint one member of the board, and the arbitrators are not to receive compensation from the states. But there is nothing to prohibit them from receiving compensation from the fiduciary.

Each state shall pay its own expenses of witnesses, and so forth, for the trial. The idea in the back of the committee's mind was that this arbitration board could travel around like a referee in this Green case from place to place and take testimony wherever it was necessary. Then as was pointed out by Mr. Schnader, I think, one section of the statute prescribes that although the board has discretion to make rules as to admissibility of evidence, yet in determining domicile it shall follow the rules of the American Law Institute.

If during the pendency of a case one of the tax commissioners is convinced he is wrong, he can withdraw and the case will go on with the others.

As soon as a tax commissioner receives notice of the choice of the fiduciary for arbitration, the tax commissioner is to notify his own courts that are handling the estate and those courts are ousted from any jurisdiction, and by a subsequent section all tax proceedings are suspended until this question of domicile is settled.

For the sake of the record I think I should make reference to a recent act of congress which we did not include in our report because we do not think it has direct application. It was passed August 21, 1937, Public Law 332 in the 75th congress. I shan't read it, although it is short, but it amends subsection 1 of section 24 of the judicial code by saying that prospectively no federal district court shall have jurisdiction of any suit to enjoin the assessment of any tax under the laws of any state where a speedy and efficient remedy may be had at law or in equity or in the courts of such state.

That however in our opinion does not touch the interpleader act which is subsection 26 of section 24, and although it does show congress' intention with respect to certain matters we do not believe that section 26 has been affected by this. That is why we did not make reference to it in our report.

CHAIRMAN GIRDWOOD: Thank you, Mr. Knapp.

Is there any other discussion on the report of the committee on double domicile? If not, the next thing on the program is a report of the committee on resolutions of the conference. The report will be submitted and acted on at the next meeting. Mr. Maxwell, I think, is chairman of the committee.

A. J. MAXWELL (North Carolina): Mr. Chairman and Members of the Conference: At this late hour it is rather fortunate that the rules governing the conference provide that the report of the committee on resolutions shall be presented at one session and action taken on the resolutions at a subsequent session. Of course, another reason for this rule is to give every member of the conference opportunity to whet his hatchet before final action is taken.

It is my impression that perhaps no other subject has been discussed at this conference with as much feeling as the subject of the undistributed profits tax. There were three separate resolutions presented from the floor on this subject of varying degrees of condemnation of the tax, but none of them stopping short of complete condemnation of it. The resolutions committee was able to reconcile conflicting views and is presenting a proposed substitute for the three resolutions from the floor.

There is a rather old story told in my home town about two gentlemen who were engaged in the cotton supply business, in a partnership. A farmer friend came in one morning and asked a member of the firm what he thought about the price of cotton. His answer was, "It may go up or it may go down, but please understand that that is my personal opinion and not the opinion of the firm."

The resolution agreed upon by the committee is not quite as innocent as that but it does avoid the use of a meat axe.

The following is a substitute for the resolution presented, one of them jointly by Senator Edmonds and Professor Lutz, one by Mr. Seidman and one by Mr. Hoffman.

"RESOLVED, That if the undistributed profits tax is to be continued this conference recommends modification of it at least to the extent of exempting from the additional tax earnings used to reduce indebtedness, to provide for reasonable expansion, or to accumulate surplus to provide reasonable safeguards against insolvency in times of depression."

The following is a substitute for a resolution presented by Mr. Lamb, Mr. Boyle, and Mr. Bradley:

"RESOLVED, That this conference request the National Tax Association to appoint a committee to give further consideration to the question of allocation of income for state income tax, in the hope that further progress may be made in the direction

of uniform legislation and administrative practice, and to promote comity between the states in income tax administration."

A resolution was presented—the copy of the resolution did not give the name of the author. I read the resolution as presented:

"RESOLVED, That the conference recommend to the National Tax Association the continuance of the committee on property tax limitation and homestead exemption, and that the assignment of the committee be broadened to include the formulation of the concept of property as a subject of taxation."

The committee reports the resolution with the elimination of the latter clause, that is to say, we report the resolution for the continuance of the committee on property tax limitation and homestead exemption. The committee voted to eliminate the latter clause partly for the reason that it did not quite understand what was in the mind of the author of it. It is my understanding since the meeting of the committee that it is desired to have its scope extended. I don't know that the committee would have any objection to such extension of it, if the language should be proposed in such terms as could be easily understood by the man on the street.

This is a resolution presented by Senator Edmonds and Professor Lutz:

"RESOLVED, That this conference hereby request the National Tax Association to appoint a committee to consider the question of the taxation of capital gains."

The committee undertook to make an incidental correction in the English employed by Senator Edmonds and Professor Lutz to the extent of eliminating the word "entire," and adding, after the words "capital gains," "by the federal and state governments," because the question is one with respect to states as well as the federal government.

Another resolution approved by the committee:

"RESOLVED, That this conference request the National Tax Association to continue the committee on double domicile in inheritance taxation."

A rather long resolution presented by Mr. Ramsey of Florida, read from the desk yesterday, was considered by the committee to be too broad in its scope to come within the rules prescribed by the National Tax Association, and for this reason, on motion, that particular resolution was referred to the executive committee of the National Tax Association, for such action as it may see fit to take with reference to it.

Finally, our usual resolution of thanks, and while it is brief it is none the less genuine. I might say that with respect to particular reports presented to this conference the resolution might be said to

be semi-silent, but it is comprehensive in its inclusion of every report presented to the conference:

“RESOLVED, That the thirtieth annual conference on taxation express its high appreciation to those in charge of arranging for the accommodation and entertainment of its delegates and guests and particularly thanks to all those participating in the program with contributions which evidence painstaking and studied efforts and are a distinct contribution to current tax literature.”

Mr. Chairman, I am glad to present this report on behalf of the committee on resolutions and to lodge the customary motion for action at a later conference that the resolutions be adopted by the conference.

CHAIRMAN GIRDWOOD: You have all heard the report of the committee and the motion made by the chairman of the committee. Under the rules it will lie over until the next session of the conference.

I shall turn the meeting over now to the president of the association, Judge Leser.

PRESIDENT LESER: In turning over this meeting to me, the chairman has imposed upon me the very arduous function of declaring the meeting adjourned.

THIRTEENTH SESSION

THURSDAY, OCTOBER 28, 1937, 8 P. M.

PRESIDENT OSCAR LESER, presiding.

PRESIDENT LESER: The meeting will come to order, please.

This is the last session of the National Tax Conference of 1937, in many respects, I think, considered most successful. I say that not because it was held in Baltimore, or because I had a small part in arranging for this conference, but because the secretary assures me that is a fact.

The evening will be illumined by two interesting addresses by two interesting men. The first of these is a native of this state, a graduate, I believe, of Harvard, if not of the Harvard Law School, one who, while a prominent practicing lawyer, has had a good deal to do with taxation in this state. In 1929, as chairman of a special tax revision commission, he presented a report which was in its main features accepted by the legislature. There were some changes made. I don't think that the changes that my commission urged upon the legislative committees to that report exceeded a hundred. But they were not substantial.

One of the interesting changes made on the recommendation of this committee was to revolutionize the old idea that the statute sets forth what shall be taxed and also what shall be exempt, and then has an omnium gatherum clause which provides that all other properties shall be subject to taxation. That principle has been reversed and in Maryland today only those things are subject to taxation which the statutes say shall be taxed. The reason for that was that the courts found so many ingenious ways of avoiding the taxation of certain forms of property by holding that they were not brought within the meaning of the statute. So it was deemed best to tell the world and let any man know by reading that statute what property was subject to taxation.

Mr. Machen himself was the hero of a very extraordinary case which came up before the court of appeals, in which it held that bank deposits, although evidenced in writing, were not property. I believe, however, that the court decided that case on grounds not urged by him, and that he was almost as angry at the decision as the other side which lost the case.

He is also the hero of a case now pending in the supreme court of the United States which, I understand, involves the right of the government to call in a certain issue of Liberty Bonds before the

date of maturity. It has some relation, I believe, also, to the gold question. I hope he will touch on that.

I would be very glad indeed if he could settle a few things that have been bothering me for years and to which I haven't found the answer. One of them is, what is the meaning of the words "ability to pay?" I haven't found anywhere any answer to that question. Mr. Rockefeller's ability to pay a street car fare might be a million dollars.

The other is the phrase "earned and unearned income." I would like somebody to tell me why any distinction is made between those two types of income in any statute.

Finally, I am puzzled to know what is the difference that people make, some people in high places, between human rights and property rights. I have always supposed that the right to own property and use it is a human right. The legislation dealing, for instance, with the interests of the laboring man is aimed at securing to him the fruits of his labor, which is in the form of property.

Having said that, I am prepared now to introduce the speaker, Mr. Arthur W. Machen, of Baltimore.

ARTHUR W. MACHEN (Maryland): Mr. Chairman, Gentlemen of the Tax Conference: My friend, Judge Leser, has greatly overpraised me, but there is no need for me to say that, because you will find it out soon enough.

I could answer to my own satisfaction some of the questions which he has propounded, but as it will not be within the subject of my discourse I will pass them by.

I should say, however, in one of the cases to which he refers with which I am concerned, I was not only satisfied with the result but entirely satisfied with the reasoning which followed the reasoning of our brief.

TAXATION IN MARYLAND AS AFFECTED BY THE NEW DEAL

ARTHUR W. MACHEN

Attorney-at-Law, Baltimore

I am going to speak to you about some problems of taxation in the small, thin and once sovereign state of Maryland. Our problems are not very different from those in the other 47 states, except for two circumstances—in the first place, the geographical configuration of this small state, and in the second place, the state's history and traditions, and the individuality which is characteristic of all border states, jealous of large neighbors on either side.

Both these factors have always been operative in Maryland, but both have been greatly accentuated in recent years.

The state was always a small state, but never so small as at the present time. It took George Washington a day to go from Mt. Vernon to Baltimore and two days to go from Baltimore to Philadelphia. But as no point in the state is more than thirty miles, as the crow flies, from some adjoining state, you can now start from *any* place in Maryland after breakfast and proceed in your own Ford car—with the aid of a motor boat if you live at some points in southern Maryland—to an adjoining state, in ample time for an early lunch, and after spending three or four hours, or even more, be easily back at home for dinner at the usual hour. Of our 23 counties, all but four border on some other state.

But while this centralizing tendency has been at work, divisive forces, separating us from the states both to the north and to the south, have also had full play. Even in the days before the Civil War, while we were united to the south by the "peculiar institution," we were also united to the north by commercial ties and by an open northern frontier. When the cataclysm of the Civil War descended upon us and divided our people, and when Appomattox had left us, divided among ourselves, in a new union, the only way we could get along in any sort of peace and harmony was by emphasizing our individuality and our distinctiveness, both from Virginia on the one side and Pennsylvania on the other. This separateness became, therefore, a matter of state pride, and was doubtless one of the causes why in the days of national prohibition we were the only state in the union which never adopted a local Volstead act.

These centripetal and centrifugal forces have not been, and are not today, without influence upon our tax system. We should like to be independent in our taxes, as in other matters; but the inexorable exigencies of our geographical configuration and situation, and in recent years, even antedating the first election of Franklin D. Roosevelt, the power of the federal government, have been operating to deprive us of our independence and freedom of action. Our constitution still declares that we are "a free, sovereign and independent state." But Mr. Justice Holmes, some years ago, described this and other states as "quasi-sovereign"; and in these latter days it would be more appropriate to discard even that left-handed deference to constitutional theory and describe us as an "ex-sovereign state." Quite as truly as in the days of 1861, we may say to our state, in the words of "Maryland, My Maryland," "The despot's heel is on thy shore"; and in matters of taxation, as in other things, we must heed our master's voice and obey his stern commands.

In the days when we were really free, we started out like most of the states with the general property tax. We declared in our four constitutions from 1776 to the present, adopted in 1867, "Every person in the state, or person holding property therein, ought to

contribute his proportion of public taxes for the support of the government, according to his actual worth in real or personal property." Could anything be simpler or fairer than this? Of course, this rule prohibited the new-deal policy of "soak the rich." Every person, rich or poor, was to pay "according to his actual worth in real or personal property." In spite of all the modern evangel of progressive taxation, designed to be levied, not in proportion to the taxpayer's means, but according to some supposed rule of "equality of sacrifice," I am still so horse-and-buggy-minded as to think that our traditional principle was essentially sound.

But the principle broke down in its practical application long before the federal pressure to which I have adverted began to be exercised.

The first step in this process was when our legislature abandoned the rule which had prevailed in 1778 and for one or two years thereafter of assessing the "actual worth" of each person according to the *annual* value of his property (Act of October 1778, Ch. 7, Sec. 2), and substituted the rule of *sales* value as the criterion (Act of October 1780, Ch. 25). This meant that non-productive property, property incapable of producing any revenue, or very little revenue, should nevertheless pay taxes just as if it were producing, or capable of producing 6, 10 or 12%. The result was that if a man owned a work of art, let us say, he was, if the law was enforced, taxed to death. But it was certainly to the interest of the community that citizens should possess works of art; their existence in the community enures to the benefit not merely of their owners but of everybody. Taste is improved, and education furthered. Many other illustrations of the impolicy of taxing property, not according to its annual value but according to its sales value, might be given.

The result of course was, here as elsewhere, that the enforcement of the law broke down as completely as the enforcement of the eighteenth amendment. The only way the law could be made tolerable was by means of pardonable perjury on the part of the taxpayers, and a wise violation of their oaths of office by the taxing authorities.

The second cause of the collapse of the system of requiring everybody to contribute to the support of the state government "according to his actual worth in real or personal property" was the extraordinary development of intangible personal property—stocks, bonds, etc.—particularly of corporations doing an interstate or even international business. I will not weary you by narrating many of the legislative expedients, partial and imperfect as they were, to alleviate this situation. The situation here as elsewhere became in process of time utterly impossible, particularly as intangible property, as well as real estate, was assessed according to its sales value

rather than its annual value. It was simply preposterous to tax a man owning a 4% bond, saleable at par, at the general rate "according to his actual worth in real or personal property"—say, about \$2.50 per hundred dollars of sales value. He would thus pay about 62½ of his income from the bond in taxes.

We then worked out a statute, first of doubtful constitutionality but afterwards ratified by constitutional amendment, taxing corporate bonds and stocks in foreign corporations at a fixed rate—much lower than the rate ascertained by the simple rule of taxing everybody "according to his actual worth in real or personal property." This was the famous Newcomer act of 1896 (Ch. 143), devised, I have been told, by Mr. B. F. Newcomer. This statute was of course a complete abandonment of the constitutional rule of levying taxes according to the taxpayer's "actual worth in real and personal property." Moreover, the statute, although it did not go back to the sound rule of taxing according to the annual value instead of the sales value, yet approximated crudely that rule, by providing that securities subject to the tax, which paid no interest or dividends and therefore had no annual value, should not be taxed at all.

By means of this and other supplementary devices, such as taxing domestic ordinary business corporations on their property and exempting their shares of stock, etc., etc., a system was worked out which was horribly complex and utterly illogical, but which yet was tolerable in practice, especially when administered by officials endowed with common sense.

The system was enormously complicated by various devices and substitutionary taxes. For instance, the personal property of domestic corporations, other than ordinary business corporations, was exempted from taxation, but the shares were nominally assessed to the holders, though the taxes were actually paid by the corporation, the assessment being ascertained by deducting from the aggregate valuation of the shares the assessed value of the real estate, which was taxed to the corporation, and by dividing the residuum by the number of shares.

Mutual savings banks were not taxed on their property according to the constitutional rule of levying taxes according to each person's actual worth in real or personal property; but their property was wholly exempted, and they were taxed on the amount of their deposits. This system of taxing a bank on the amount it owed, instead of on the amount it owned, was, in form at least, the very antithesis of the constitutional rule. It reminds me of a small girl who remonstrated with a shop-keeper for refusing her credit for a stick of candy by saying, "Don't you know my father owes thousands and thousands of dollars all over this city?"

I might talk till midnight without exhausting the complexities of our general tax system, if system it could be called.

Then, of course, we had various special or additional taxes. The constitution expressly provided that in addition to the general property tax laid according to each person's actual worth in real or personal property, "fines, duties and taxes may be laid or imposed with a political view for the good government and benefit of the community." Nobody knew just what this meant, but at all events we have always had a host of licenses and other special taxes.

Since 1844 we have had an inheritance tax, but until recently only on collateral successions and always at a flat rate with no exemptions, except a provision that where the total estate—not the amount of any legacy—is less than \$500, no tax should be collected. This latter exemption has recently been altered.

A very moderate tax is imposed on the capital of foreign corporations doing business in the state, in addition of course to the regular property tax.

In 1929, we tried to recodify the tax laws so as to create some sort of harmony out of the maze of conflicting, often contradictory, and generally illogical statutes. Some progress in that direction was doubtless made; but an approximation to some sort of symmetry was all that could be accomplished.

In addition to the state and county taxes, which are always levied upon a county assessment, we have over a hundred incorporated cities and villages, each with its own separate legislative charter and frequently endowed with power to make its own assessments, which may be higher or lower than the county assessment of the same property. In 1929 an effort was made to correct this wasteful and absurd state of the law; but various towns and villages raised such a howl that the attempt had to be abandoned. Some claimed they could not carry on at all unless they were allowed to fix a municipal assessment higher than the county assessment, which was often made too low, in order to prevent the people of the county from contributing their fair share of state taxes. At least one small city said its municipal assessment had to be lower than the county assessment because it had issued bonds requiring a certain percentage of the local assessment to be paid into a sinking fund, and that if it was not allowed to cheat its creditors by paying into the sinking fund less than the required percentage of the actual value of its assessable property, it would be ruined. The art of cheating creditors had not then been raised to the state of perfection it has reached since 1932, and this plea therefore did not commend itself to some members of the general assembly; but the opposition to the reform came from so many quarters that, as already stated, the attempt had to be abandoned.

But although the tax laws were confusing and illogical and in some cases unequal, yet their practical application seemed to suit our people.

In 1924, in the administration of President Coolidge—now supposed to be the hey-day of orthodoxy, but, as it seems to me, the time when the seeds were planted of all the ills which have since choked us—the federal government started to force supposed reforms in our tax laws upon us. In that year, as you all remember, congress with the approval of President Coolidge adopted the iniquitous plan of crediting state inheritance, estate and succession taxes against the federal estate tax, thus virtually forcing the several states to levy death duties of one form or another at least as high as the federal credit. The supreme court apparently upheld the constitutionality of this blow at the independence of the states in respect to the most vital attribute of sovereignty (*Florida v. Mellon*, 273 U. S. 12, and *Rouse v. United States*, 278 U. S. 638). Although I thought this action of the supreme court one of the most unfortunate in its history, I was not in favor of packing the court in order to get around it. Thereafter, however, there was nothing for Maryland to do but bow to the federal command, and impose an estate tax equal to the excess, if any, of the federal credit over the state inheritance taxes.

This would have been bad enough, even if the policy of the federal estate tax had been wise. But I am convinced that the federal estate tax, with its high and progressive rates, is one of the worst taxes ever devised. It does not even have the merit of forcing the breaking up of vast fortunes. For example, if a decedent, leaving an estate of \$1,000,000, bequeaths one hundred legacies of \$10,000 each, his estate pays the same tax as if he had bequeathed the whole million to one person. The same tax is paid if his estate remains concentrated in one person, as if it were distributed—a redistribution of wealth—among many. In other words, the tax is a mere penalty upon success and thrift. Moreover, by compelling wealthy men to keep their estates liquid instead of enabling them to venture their capital in business and thus start the wheels of industry moving, it constitutes one of the most serious obstacles to recovery in any period of financial depression.

Then the system of federal aids to the states by bribing them to match federal appropriations or forfeit the right to have any portion of those appropriations, even those collected from their own people, expended within their borders, has still further limited the freedom of action of the once sovereign states in matters of taxation. This system, which began with the maternity act of 1921, has been carried to Gargantuan extremes under the present administration.

To meet these increasing federal requirements, as well as to provide for the normal needs of the state and local governments in a time of diminishing values of real estate and increase in the cost of living, Maryland, in common no doubt with most other states, has been hard put to it.

Most thoughtful persons outside the legislature, but unfortunately very few members of that august body, felt that a general sales tax furnished the most available expedient. Of course a sales tax in a small state shaped like Maryland must of necessity be very moderate or else purchasers will be driven to adjoining states or the District of Columbia. But particularly in the counties near the District of Columbia violent opposition was aroused to any such tax, however moderate, and the effort had to be abandoned.

The problem first became acute in the general assembly of 1935. Additional revenues had to be raised, and where were they to come from? Tax proposals poured down as thick as leaves in Vallambrosa. Almost everybody advocated a different tax from anybody else, and nobody really wanted any of them. Finally, out of the confusion, there emerged a tax of 1% on gross receipts from retail sales of tangible personal property payable by the vendors (Act of 1935, Ch. 188), an inheritance tax of 1% on lineal successions, and an increase in the collateral inheritance tax from 5% to 7½% (Acts of 1935, Ch. 90), and an automobile titling tax (Act of 1935, Ch. 539). The gross receipts tax was to continue in force for one year only.

The gross receipts tax was, like most taxes, intensely unpopular with those who paid it, and as they were very numerous, organized and influential, it was never revived after the year for which it remained in effect. The state had no adequate machinery for enforcing the tax, and there were doubtless wholesale frauds and evasions. The constitutionality of the act was sustained by the court of appeals.

The automobile titling tax of 1% on the market value of each motor vehicle for which an original certificate of title is issued was primarily intended as a substitute for the gross receipts tax on sales of motor cars; for a levy of a tax on gross receipts from interstate sales of automobiles would have been unconstitutional. The act shows on its face that the legislature had some doubt as to the constitutionality even of the titling tax; but its validity has never been successfully questioned. It is an excellent form of taxation, and deserves to be considered by other states.

The imposition of a lineal inheritance tax, and the increase in the rate of the collateral inheritance tax, was peculiarly ill-considered and unintelligent; for the burden fell principally on small or moderate estates. This was true because on large estates it simply decreased the amount of the Maryland estate tax which is levied in an amount equal to the excess of the 80% credit allowed by the federal revenue act of 1926 over the amounts collected as inheritance tax. As to large estates, the only effect was to diminish the amount payable as Maryland estate tax and to increase by precisely the same amount the sums payable as inheritance tax. Consequently the in-

heritance tax law of 1935 from estates passing to lineal descendants raised no revenue except on estates of more than \$257,000; and the full burden of the tax was felt only by estates of less than \$100,000. In respect to estates passing to collaterals, the increase in the rate from 5 to 7½% was felt in some diminishing measure by estates up to \$4,000,000, but fell principally upon estates of less than \$1,740,000.

In March of the following year, 1936, tax needs caused an extraordinary session of the general assembly. The same chaos, the same clashing of conflicting interests, as had prevailed in the regular session of the preceding year, was again rife.

The motor vehicle titling tax was increased from 1% to 2%. A tax of about 2½ cents a gallon was imposed on sales of beer to retailers, a manufacturers tax on distillation of spirits—of which more anon—was levied, also a tax on gross receipts from admissions to places of amusement, as well as a tax of 10% on sales of toilet articles and cosmetics, and finally the franchise tax on foreign and domestic corporations was increased. See Acts of March, 1936, Ch. 3. All these taxes were temporary merely; that is to say, they were to continue in force for one year only.

Under federal pressure the governor called another special session of the general assembly in December of the same year in order to pass an unemployment compensation law. Two special sessions of the general assembly in one year are, I believe, absolutely unique in Maryland history; but nowadays when the federal government raises its strong arm, there is nothing for the states to do but cower in the dust. A bill was accordingly passed which it was supposed would meet the federal test; but, so abject is the condition of the once sovereign state of Maryland, that the governor in signing the bill took the unprecedented course of advertising our serfdom by appending to his signature the following explanation:

“Having been advised by the Federal Social Security Board that the unemployment insurance bill, as enacted by the general assembly in recent extraordinary session, must first be approved by me before that board can certify that it meets the minimum requirements of the federal law, I have this day affixed my signature, and shall immediately send the completed bill to Washington for approval.” (Acts of December 1936, p. 36.)

This act, of course, levied taxes upon employers for contributions to the insurance fund.

At the regular session of the legislature of 1937, when the so-called emergency tax laws of 1936 were about to expire, the same state of confusion worse confounded which had existed in 1935 and 1936 again showed itself. Indeed, the outcome of the session was a comedy to which only Gilbert and Sullivan could do justice. For

years the evening edition of the leading newspaper of the state, the *Baltimore Sun*, had been declaiming against the folly of allowing bookmakers, while nominally prohibited, just like bootleggers in the days of national prohibition, yet in practice to operate tax-free. Why not get a revenue from licensing them just as we had done before repeal from bootleggers and speakeasies? This was the almost daily screech of the *Evening Sun*. And so the general assembly, doubtless thinking it would have the applause and approbation of the *Sun* papers, passed a tax bill, a basic part of which was a license tax on bookmakers; and then adjourned *sine die*.

Did the *Sun* papers applaud? Not at all. The *Evening Sun* refrained from so far eating its words as to condemn the action of the general assembly, and preserved complete silence. But the *Morning Sun* launched a violent tirade against the iniquity of licensing bookmakers, and called upon the governor, loudly and incessantly, to veto the bill. To this appeal the governor, although of a different political party, did not turn a deaf ear, and vetoed the bill. He was thus under the necessity of reconvening the legislature immediately in extraordinary session.

As for me, I regret that the governor did not sign the bill, and see what would happen. Of course, the *Morning Sun* said that if we should follow the advice of the *Evening Sun* and license bookmakers, all the thugs and crooks in America would flock to Maryland. I am not convinced that such would have been the case, and at least would have liked to see the experiment tried. If the *Morning Sun* should have been proved to be right as to the untoward results of following the course so strongly and persistently advocated by the *Evening Sun*, it would have been time enough, it seemed to me, to convene the legislature in extraordinary session, at considerable expense to the taxpayers, after those dire results had begun to materialize.

At all events, it is certain that the action of the governor, in vetoing the tax bill passed at the regular session and calling a special session to pass a substitute, resulted in a bill ten times worse than the bill he had vetoed.

The cardinal feature of the bill passed at the special session of 1937 in place of the vetoed bill, is an income tax at the flat rate of one-half of 1%. The bill was drawn in two or three days, and, if due allowance be made for the haste with which it must have been prepared, is a pretty good piece of draftsmanship. (See Acts of 1937, Special Session, Ch. 11, pp. 33-54.) In basis it is modelled on the federal laws but with some obvious improvements.

The most vicious feature of the federal law, namely, the taxation of capital gains as income, with a corresponding deduction of losses on sales of capital assets, is adopted, but with a provision that neither gain nor loss shall be recognized if the property sold was held

for more than two years. This considerably mitigates the evil, but does not wholly remove it. The tax on capital gains, and the deduction of losses on sales of capital assets is a most prolific source of litigation. I once made a rough computation of the proportion of income tax cases in the B.T.A. reports due to the taxation of capital gains and the deduction of corresponding losses. In the volume I chanced upon, the cases on capital gains and losses were about 50% of the total, so that about half of the income tax litigating could be avoided if the taxation of capital gains and the deduction of capital losses were eliminated. In addition, the treatment of capital gains as if they were income introduces an extraneous factor into the market, and makes for artificial prices.

The state income tax is, at least in many of its features, of doubtful constitutionality; but the rate is so moderate that it is uncertain whether its validity will be challenged, more especially as the general assembly at the regular session of 1937 unfortunately submitted to the people a constitutional amendment authorizing a progressive income tax. The special session of 1937 also re-enacted the manufacturer's tax on distillers (Acts of 1937, Special Session, p. 27). This tax, as already stated, had been imposed for the first time by the special session of 1936. It exists, or at least up until the beginning of 1937 existed, in only one other state. The validity of the tax of 1936 was challenged in the courts because it allowed a credit against the tax of the amount of the excise tax on sales to retailers in Maryland, thus in effect imposing the tax at a discriminatory rate on spirits shipped out of Maryland. The validity of the law was sustained by a three-judge federal court, and counsel did not think it worth while to exercise their right to appeal to the supreme court of the United States.

Nevertheless, the legislature seemed to have been so alarmed by the contention that, in the act of 1937, the provision for the credit was eliminated! The last state of the distillers was therefore worse than the first, except that the rate was reduced.

This distillers tax is, however, worthy of your consideration, because it seems to me a good example of a bad tax. The tax is imposed and collected as soon as the whiskey is distilled; but of course the whiskey is not marketable until some years later. In other words, the tax, although denominated a manufacturer's tax, is not levied upon the completion of the manufacture but upon goods in process. Moreover, the tax is collected from all liquor distilled, though much of it must evaporate before being marketable. The tax is therefore imposed upon liquor that evaporates, and is therefore never marketed. Furthermore, unless other states adopt similar taxes, it will drive the distilling business out of Maryland.

Whither are we going in matters of taxation? Who knows? I cannot even attempt to guess. Of one thing, however, I am sure—

namely, that the system of excessive taxes, especially federal, must eventually break down by force of their own weight. So-called loop-hole plugging is a popular presidential pastime; but while of course taxes should be so laid as to prevent evasion, or if you will, avoidance, yet the higher taxes become, the greater is the certainty they will be avoided. If they become too burdensome, their enforcement will become as impossible as the enforcement of the national prohibition law. In time, if present tendencies continue, there will inevitably be a complete breakdown of tax enforcement. A false income tax return will be popularly regarded as no more culpable than buying liquor from a bootlegger in the days of national prohibition.

Of course, if the country is going to avoid a major disaster—in fact, universal bankruptcy and a redistribution of wealth in the sense that the most astute and unscrupulous will possess the wealth now possessed by those who have acquired it by honest work, or inherited it from ancestors who acquired it by honest work—that is to say, by those who may be presumed to have a capacity to use it properly and to acknowledge a responsibility to use it for the benefit of humanity—then the budgets, state and national, must be balanced—not in 1938-9, or 1939-40, but *now*.

This must mean curtailed expenditures and increased taxation—not one or the other, but *both*. If the increased taxation is fair and equitable, I at least shall not grumble, even though it is necessitated by the stupendous blunders of the last four years. Shall we have the courage to adopt this course? Again, I do not know.

I have feared for some time that we are headed towards a fiscal disaster in comparison with which 1929 or 1932 would look like prosperity. Until recently, I thought that the catastrophe would probably be deferred for several years; but in view of the recent actions of the stock and bond markets I fear that it is much more imminent. With the policies of expenditure which have done so much to precipitate this calamity, this association is perhaps not directly concerned. But with the matter of raising funds to balance the budget—the question of ways and means—this association is vitally interested. It is not for me to suggest the methods. If I were a person in authority, it would be my duty to do so. But as a mere private citizen, all that I may do is to warn, according to the best of my ability. Tax laws like any other laws, must be reasonable to be enforceable. When we find taxes being avoided or reduced by such expedients as the incorporation of yachts, the first effort should be, not to plug the loophole—certainly not merely to plug the loophole—but to consider whether the law which leads to such expedients is not unreasonable, and ought not to be changed.

From what has already been said, it is probably apparent to you that I am that survival of the Eocene Age—a liberal, constitutional,

southern, states rights democrat. I still believe that taxation should be limited to the just and constitutional needs of the government, economically administered; that any taxation of one class for the benefit of another, whether of consumers or importers for the benefit of manufacturers, of dwellers in cities for the benefit of farmers, or of employers for the benefit of employees, is vicious and ought not to be tolerated; that it is the duty of the people to support the government, and not of the government to support the people; that an irredeemable paper currency is the abomination of desolation, and that every dollar should represent a hard, metallic content which the owner should be allowed to export, or melt down and dispose of, as he will; that contracts, public or private, should be inviolably performed even if performance bankrupts the contractor; and, finally, that the preservation of individual liberty is the only just end of government, and that it is far better to starve in freedom than to live in surfeit in slavery, whether the master be one individual or that hydra-headed monster known as the populace.

Perhaps this confession of faith may cause some of you to discount the opinions I have expressed on taxation. But taxation is not only a very practical matter, but it cannot wholly be divorced from the objects for which the taxes are laid; and I cannot conclude without a frank avowal, even at the risk of alienating some of you. If expenditures continue to exceed tax receipts, bankruptcy—national, state, municipal, corporate and individual—will be soon upon us; and if taxes thereafter continue to be levied for the purposes now avowed, despotism in the United States is inevitable.

I am confirmed in this latter opinion by a passage I ran across the other day in Hodgkin's *Italy and Her Invaders*, in which, writing in or about the year 1873, after discussing some of the causes of the fall of the Roman Empire, he concludes as follows:

“ But of all the forces which were at work for the destruction of the prosperity of the Roman world none is more deserving of the careful study of an English statesman than the grain-largesses to the populace of Rome. Whatever occasional ebbs there may be in the current, there can be little doubt that the tide of affairs, in England and in all the countries of western Europe, as well as in the United States of America, sets permanently towards democracy. Will the great democracies of the twentieth century resist the temptation to use political power as a means of material self-enrichment? With a higher ideal of public duty than has been shown by some of the governing classes which preceded them, will they refrain from jobbing the commonwealth? Warned by the experience of Rome, will they shrink from reproducing directly, or indirectly, the political heresy of Caius Gracchus, that he who votes in the forum must be fed by the state? If they do, perhaps the world

may see democracies as long-lived as the dynasties of Egypt or of China. If they do not, assuredly now as in the days of our Saxon forefathers, it will be found that he who is 'giver of bread' is also lord. The old weary round will recommence, democracy leading to anarchy, and anarchy to despotism, and the national workshops of some future Gracchus will build the palace in which British or American despots, as incapable to rule as Arcadius or Honorius, will guide mighty empires to ruin amidst the acclamations of flatterers as eloquent and as hollow as the courtly Claudian."

If we levy taxes for those purposes we, or at least our descendants, will, I am convinced, meet the same fate. If left to ourselves, we in Maryland would never, at least at this time, levy taxes for these purposes, so fatal to the state; but under the federal pressure of the present administration, what can we do but bow to the storm in the hope that before ruin is inevitable the American people may recover their sanity and permit the states to adopt a sounder system of taxation?

PRESIDENT LESER: In Mr. Machen's reference to the distillers' tax and his recommendation that other states should adopt it he possibly overlooks the fact that there are very few states that have distilleries. I believe there are only five states which have absolute prohibition at the present time, Mississippi, Tennessee, Alabama, Arkansas and Oklahoma. In these states I have an idea that they are also raising taxes to counteract the effect of prohibition. They are raising taxes to pay policemen to hunt down the bootleggers and the moonshiners and support a certain lot of people in the public boarding houses known as jails and penitentiaries.

Mr. Machen tells us that two special sessions of the legislature in one year is unprecedented in the history of Maryland. But it may interest you to know that in one state, the state of Louisiana, they had five special sessions in one year. Of course, I need only to tell you that was during the régime of Huey Long.

I have been told that on the island of Malta there is no taxation. Some statistician probably could verify that. I thought that was a unique situation. But very recently I read in the paper a story that the town of Oyster Bay on Long Island will levy no taxes in 1938. I was sufficiently interested to investigate the reason for that, only to find that under the new charter of the county, the expenses of running the health department and the other public service departments has been put upon the township, thereby relieving the town.

Whenever I see our next speaker I have to recall very hard to visualize that so highly dignified a man as he would be displaying himself on the deserts of Arizona dressed up like Benjamin Franklin. But he made a very good imitation, and it reminded me, especi-

ally as he comes from Pennsylvania, of a good story that I heard which possibly may be new to you.

There was a dinner of the Pennsylvania Society in New York at which Senator Henry Cabot Lodge was one of the guests. Speeches were made extolling various Pennsylvanians who had achieved fame, and as he was called on to speak he said, "I have observed that in all this galaxy of notables you have omitted to mention who in my judgment are the two most eminent Pennsylvanians. Therefore, I propose herewith a toast to Albert Gallatin of Switzerland and Benjamin Franklin of Massachusetts."

This same gentleman who is to address you shortly has the further distinction of having attended the same school that I did in Philadelphia, where we were educated. At least, what little education we have we got there. I learned the interesting fact today that the school which we attended, although we didn't attend it at the same time—naturally, of course, he must have been there many years before I—was built with the proceeds of the dividend which the United States government distributed to the states out of its surplus in 1937.

Now he is to speak to us on taxation in Pennsylvania, old and new. I lived in Pennsylvania long enough to note at least two peculiarities of the Pennsylvania tax laws. One was the law imposing a tax on intangibles, called, and even officially called—I think the blanks used the phrase—"money at interest." It was a flat fixed rate, and the peculiar feature of it, which the gentleman who is to speak will no doubt explain, is that while it is called a tax on money at interest, the one thing that it doesn't tax is money at interest, or otherwise.

The other peculiar feature is that Pennsylvania does not tax—at least there is no direct property tax on tangible personal property. It is popularly supposed that Pennsylvania is very lenient to manufacturers. Well, it is when they are corporations, and there is a slight offset there to the amount of their capital stock that is relieved from the low rate, flat rate, tax on money at interest. But the real reason that manufacturers, or machinery and merchandise, are not subject to the property tax is that they are tangible personal property, and no tangible personal property is taxed in Pennsylvania.

I recall many, many years ago when I first came to Philadelphia that there was a specific tax on watches. That disappeared somewhere. I know that my father paid that tax, something like a dollar a year on watches, and I believe that in the entire city of Philadelphia, which then must have had a population of 600,000 or 800,000, there was something like 20,000 watches that were taxed.

The peculiar feature, however, of that law which imposes taxes on intangible property is that it makes an exception of hacks, omnibuses and carriages for hire. They are excepted and they are sub-

ject to the tax. Of course, that includes buggies, doesn't it? So that we have here the interesting phenomenon of a genuine tax law created and still existing which originated in the good old horse-and-buggy days of Pennsylvania. So, probably those of you who have ever heard Mrs. McGee over the radio will recall that she would probably call those "heavenly days."

With those remarks, which are not at all remarkable, I present Mr. Edmonds.

FRANKLIN S. EDMONDS (Pennsylvania): Mr. President, Ladies and Gentlemen: The program committee has made so attractive a program that I have had no opportunity to write my paper. Consequently, with your permission, I will offer some desultory remarks.

I will start by congratulating Judge Leser upon the success of this conference. My heart has been filled with admiration for him ever since as a small boy in the Central High School, in knickerbockers, I remember an alumni gathering when the judge was presented to us as one of our oldest and leading alumni.

As regards Henry Cabot Lodge, he completed his education in Philadelphia in 1906, at the dinner which the American Philosophical Society gave to commemorate the two hundredth anniversary of the birth of Benjamin Franklin. Dr. S. Weir Mitchell was presiding upon that very happy occasion and Senator Henry Cabot Lodge had been invited to deliver the oration. There was a great deal said in the preliminaries about Franklin and what he had meant to Philadelphia and the life of the nation, and when Henry Cabot Lodge got up he demurred. He said, "Remember, my friends, that Benjamin Franklin was born in Boston."

"Not at all," said Dr. Mitchell, "not at all. He was born in Philadelphia at the age of seventeen."

With that by way of preliminary I will turn to the topic on the program—Taxation in Pennsylvania, Old and New.

Pennsylvania is a great industrial and agricultural state. By the half-census of 1935, it has a population of 10,067,000, of which more than 8,000,000 are native whites and about 500,000 native negroes.

It has 15 cities within its limits of greater than 50,000 population. Even the empire state of New York has but 13. But under the beneficent influence of Henry Long up in Massachusetts, they have 16. When you have cities above 50,000 it is a sign that industry has gathered there to a remarkable degree. They are self-containing units which have in themselves whatever is needed for the happiness and prosperity of their people.

I have some very interesting figures concerning education in Pennsylvania. By the statistical abstract of 1936 we have illiterates, persons of voting age, males, 3.9 per cent; females, 4.4 per cent. But New York has 3.9 per cent males, and 5.4 per cent

females. Massachusetts has 4 per cent males and 5 per cent females. The average of New England is 4.3 and 5.1, as compared with our 3.9 and 4.4. We therefore feel that we have a remarkable literate and intelligent population.

What do they do? Seventy-five and one-tenth per cent of the males work. Twenty and seven-tenths per cent of the females work, as compared with 26.9 per cent in New York and 29.2 per cent in Massachusetts.

Two hundred forty-three thousand eight hundred fifty are employed in farming. That is more than in all New England. One million two hundred three thousand seven hundred seventy-two are employed in the more than 35,000 manufacturing establishments. That is more than in Delaware, Maryland, the District of Columbia, Virginia, West Virginia, North Carolina, South Carolina, Georgia and Florida. Two hundred ninety-nine thousand thirty-eight are employed in the extraction of minerals from the soil. That is more than in the 18 other states of the union that lie east from the Dakotas to the Atlantic Ocean and north of the Ohio valley. It is an empire state, and it is peopled with a most interesting group of people; Benjamin Franklin was accustomed to say one-third English-Quaker, one-third German, and one-third a mixture of all the other races on the face of the earth. There are 4 dominant traits in our population, traditionally. The English-Quaker with his simplicity and thrift has left his impression on our people. The Pennsylvania German with his high degree of industry has left his impression on our people. In the far west of the state the Scotch-Irish with their inventiveness and originality have made a marked contribution to our state. Up in the northern tier of counties, which was originally claimed by Connecticut, there the Connecticut Yankee settled, and he has made his contribution along the line of shrewdness and merchandising and general quick-wittedness. All together they make a remarkable population.

If this were the fourth of July I would now proceed to speak a little about Pennsylvania foods, scrapple, cream cheese, Philadelphia squab, Philadelphia ice-cream, Hershey's chocolate, Heinz' pickles. Why, Mr. President, when I gaze upon this magnificent audience it comes to me with a certain sense of tragedy that probably 90 per cent of you do not know what it means to dunk the shoo-fly. Do you think they do, Mr. President? We will have to invite you to return to Pennsylvania in order that you may have full measure of hospitality along this line.

Then I would like to say a word also about our wives and children, but I am going to restrain myself on that subject. If you require any testimony as to the home life of Pennsylvania, as it is said at the home of St. Paul's Cathedral in London in that memorial to Sir Christopher Wren, "*Lector, si monumentum requirens,*

circumspice."—If you require a monument, look about you. There are Pennsylvania women in this audience. So much, then, for this happy state.

About 15 years ago, after the war, it became quite apparent that there was a shift going on with reference to the industries of Pennsylvania. The presence of large quantities of coal and water power had led to the establishment of many basic industries in our midst. I think that gradually with the diffusion of cheap power all over the nation, many of the basic industries are declining in their importance and instead the finishing industries are coming into being. In my own city of Philadelphia, which has more than 6,000 manufacturers, the leading manufacturers at the present time, the manufacturers of Philco, employ from 10,000 to 12,000 people, and belong to a finishing industry rather than to a basic industry.

I recall one large industrial establishment which fell upon evil days a few years ago and left a large vacant plant with 660,000 square feet. While that was a basic industry which had disappeared, its place was taken by manufacturers of sweaters, manufacturers of bathing suits, manufacturers of the zipper, a Pennsylvania product, and so on and so on. Various lines of finishing goods took up all that space and took it up in a very short time. That change from basic industries to finishing industries is a change that must be borne in mind in considering the transition in Pennsylvania.

Down to perhaps 1929 the state had a budget of about \$150,000,000 every two years for the biennium period, and that \$150,000,000 was raised by a variety of taxes which I will describe as follows: First, the bonus on corporations, both domestic and foreign. Second, the capital stock tax which was fixed at a rate of 5 mills, exempting such capital as was employed in manufacturing. This was the only tax from which the manufacturer was exempt. There was no exemption from the local realty taxes or from other taxes, but there was from the capital stock tax.

Tax on corporate municipal bonds, 4 mills; tax on gross receipts of utilities, 8 mills; tax on bank stock, 4 mills; title insurance and trust company stock, 5 mills; insurance premiums, domestic at the rate of 8 mills, foreign at 2 per cent; matured stock of building and loan associations, 4 mills; tax on net earnings applicable to only a few forms of business that were not included under some other forms of taxation, 3 per cent; stock transfer tax, 2 cents per share; inheritance tax, direct, 2 per cent, collateral, 10 per cent; and an estate tax to take up the difference between the Pennsylvania tax and the 80 per cent deduction permitted by the federal law.

Liquid fuels, 3 cents per gallon; mercantile license tax, \$2 for a retail license and 1 mill on the gross, \$3 for a wholesale license and a half-mill on the gross; tax on writs, wills and deeds, usually 50 cents.

That was the standard form of taxation that existed during the period from 1920, we will say, until 1929 or 1930. There were a few variations that were attempted, such as the ill-fated tax on anthracite coal which did not last very long, but in general these taxes financed the needs of the commonwealth and produced money which was expended somewhat along these lines: about one-third for the public schools, about one-third for highways, about one-sixth for the welfare institutions of the state including the subsidized private hospitals, and about one-sixth for running the business of government.

Those were happy days. It led one of our distinguished statesmen to say on the floor of the United States Senate in a period earlier than this—in the late 90's—that Pennsylvania was the only state in the union in which the state did not tax the land of the farmer or the plant of the manufacturer. And that was true, at that time.

But as the Holy Writ tells us that even into the Garden of Eden the serpent came, so there have been recent developments which have complicated somewhat the story. The auditor-general of Pennsylvania has been very good about furnishing me with a large amount of information concerning the receipts that have been audited by his office, particularly for the last 10 years. I pay him my tribute for that, because I have a very high regard for the Honorable Warren R. Roberts as a most efficient public servant, and yet, curiously enough, I did not vote for him when he was running for office. So I make that explanation very clearly.

From 1927 to 1929—our tax year biennium ending on May 31 of the odd years—the total receipts that were audited by the auditor-general were \$281,000,000; 1929 to 1931, \$348,000,000; 1931 to 1933, \$349,000,000; 1933 to 1935, \$666,000,000; 1935 to 1937, \$811,000,000. But these figures are not altogether as clear as they should be. In that figure of \$666,000,000 for the biennium from 1933 to 1935 there is included \$62,000,000 of receipts from the liquor stores which are a state institution, and a certain proportion of that, probably not more than 15 per cent, is net to the state, but the remainder goes to conducting the liquor business. In the two years from 1935 to 1937, out of that \$811,000,000, \$150,000,000 represents the income of the liquor stores, of which, again, about 15 per cent is net to the state, and the balance is used in the conduct of the stores and in the purchase of their supplies.

During those last three bienniums the state has expended \$760,000,000 for welfare, of which about 40 per cent has been contributed by the federal government.

How has all that been done? I want to point out with great pride the marvelous record that Pennsylvania has made in financing these developments on the basis of pay-as-you-go. There has been

one loan bill of \$25,000,000 floated for unemployment relief. The rest has been paid from current taxes and from the installments that were contributed by the federal government. When you recall that from 1929 to 1936 the debt of the state and local governments increased by \$3,000,000,000, and the debt of the federal government increased by \$18,000,000,000, you will perhaps join with me in my pride in Pennsylvania, that although it involved sacrifice to meet this situation, without debt, yet, nevertheless, it has been done.

In that same period, Pennsylvania's debt went up from \$84,00,000 to \$129,000,000. That includes \$25,000,000 unemployment relief and \$35,000,000 soldiers' bonus. New York's went up from \$254,000,000 to \$588,000,000. Massachusetts' went up from \$11,000,000 to \$31,000,000, and the National Industrial Conference Board, which gave me those figures, said there was an \$8,000,000 floating debt in Massachusetts that was not included in this.

Pennsylvania has to a very large extent pay-as-you-go. And if sometimes people say that Pennsylvania is a poor state under the present hard, heavy taxes, to do business in, it is worth reflecting as to whether or not a state that has not added to its debt, or materially added to its debt during that period, does make on the whole a rather comfortable state to be in.

That is due to our Pennsylvania German ancestors. They were thrifty souls and they had a hatred of debt. If a man had \$1 and wanted to spend 90 cents, that was all right. If he wanted to and did spend \$1 or \$1.10 he was an anathema not only to his family, his church and neighbors, but everybody else. There is a great deal in having an ancestry of which you can properly be proud.

How did we raise the rest of that money? In 1935, amusement tax, 1 cent on each 25 cents. The capital stock manufacturers' exemption was removed. The foreign capital stock tax was changed to a foreign corporation franchise tax. There was a cigarette tax of 1 cent on each 10 cigarettes; a personal property tax which prior to 1935 was used by the counties alone for local government, 1 mill additional added for state purposes; corporate net income, 6 per cent; documentary stamp tax, 5 cents per 100; gross receipts of utilities increased from 8 mills to 14 mills; liquid fuels tax, 1 cent additional.

At the special session of 1936 the following happened: bank stock tax increased from 4 mills to 8 mills; title insurance tax from 5 mills to 8 mills; corporate net income tax from 6 per cent to 10 per cent; gross receipts tax from 14 mills to 20 mills; tax on liquor sold at the state stores, 4 per cent; tax on sales to the state stores, 4 per cent; personal property and corporate net income taxes increased from 1 to 4 mills. That was the 1936 crop in all of them.

In 1937, the capital stock and franchise taxes levied in 1935 were continued. The cigarette tax was continued. The personal prop-

erty tax and the corporate loans tax were continued at 4 mills for the state in addition to 4 mills for the county, making a total of 8 mills. The corporate net income tax was reduced from 10 per cent to 7 per cent. The gross receipts tax continued at 20 mills; liquid fuels tax, 1 cent additional; bank, title insurance and trust company, 8 mills; tax on liquors continued at 10 per cent. Those have been the taxes, the new taxes, in Pennsylvania.

This question arises. How has this extension of taxation affected the life of the state? You will see what has happened, that practically most of these taxes are old taxes in which the rate has been increased. Consequently those taxes can be administered without much of a breach in the system of taxation. They are understood by the people.

There have been some changes in the tax laws, and some of them, I think, have been a bit unfortunate. For instance, our capital stock tax which usually yields about \$35,000,000 or \$30,000,000 a year has ordinarily been assessed on the basis of a report that would be made in the spring of the year, and perhaps the report would be settled in the fall, and perhaps by the first of January the payment would take place.

Last year an act was passed which made the tax self-assessed by the taxpayer and required the payments to be made by March 15, which means that in the biennium the figures of which I have just given to you, there are three years of corporation taxes rather than two years. I think myself that was a mistake. I think it would have been better accounting if they had taken that three years' figure and kept it for the next biennium, because when you have three years' taxes in a two-year period you are bound to have some shortage a little bit later on.

There have been a number of criticisms of our personal property tax, and those criticisms, I am inclined to think, are valid. We now have the counties collecting 4 mills and the state collecting 4 mills on the market value of securities as of the date of the assessment. That is 8 mills on the market value. Securities have a market value sometimes when they have no income. If they are securities held in trust, it is entirely conceivable that the income of the trust may not be more than 4 per cent at the present time, and if the trust is a large one there must be 2 or 2½ per cent paid to the federal government in income tax. Add to that 8 mills on the market value of the securities and you will approach tolerably near to confiscation.

My own feeling is that that tax as now imposed by the state has done harm to Pennsylvania to the benefit of the neighboring states, and that those who have trusts or property in the form of intangible personal property that they can take from one state to another have been quite active during the last year or so in taking them from Pennsylvania to Delaware and to Maryland, to Virginia, and to other places of that kind.

But I notice that when they take them they always refer to the fact that the Pennsylvania law is only for two years and that expires by its own limitation, and when they leave on these errands they get a return trip ticket.

The foreign corporation franchise tax has also, I think, involved some difficulties which will affect business in Pennsylvania. We have a large number of wholesalers and jobbers whose business it is to distribute the goods of their manufacturer, not in Pennsylvania alone, but in quite a large surrounding district. In our corporation franchise tax we quoted from the Massachusetts corporation income tax, and in there one of the tests for computing the tax in the proportion of sales as compared with the gross sales of the company. There is a very beautiful sentence in which I recognize the fine English of Henry F. Long which says that the method of computing the sales to be computed to Pennsylvania shall be gross sales, less the sales that may be negotiated by any agent who travels from a place of business in another state.

That means that in computing the Pennsylvania tax they are trying to include the sales which are made by agents traveling from Pennsylvania in New Jersey, Delaware, Maryland, West Virginia, Virginia, and the other states which our wholesalers serve. If that interpretation is sustained by the courts, I am inclined to think that it will seriously affect the high-grade, prosperous wholesale business which has been one of the great strengths of our community. What, then, is the conclusion of the whole matter? A little while back there was a lieutenant-governor in Massachusetts who, when he was presiding over the state senate for the first time, said, "Have faith in Massachusetts." That led to the publication of a book, "Have Faith in Massachusetts." I always suspected Henry Long had a hand in the preparation of that book, but it was a very good book and it made the man whose name was on the title page the vice-president and eventually the president of the United States.

I would say to you in the same way, have faith in Pennsylvania. There is a great deal of inexperience in fiscal matters which is coming to the front in these modern times, and some mistakes may be made. But great communities do not rise over night, nor do they die over night. Great communities have their roots down deep in the soil. I have no doubt that inequalities and inequities will be discovered, and when they are discovered they will be corrected. At the present time we are face to face with a situation in which there has been an enormous expansion of the program of government without attempting to consider first how much that expansion was going to cost.

Having been committed to the program, there follows then that you must raise the money in any way that you possibly can without considering whether you are raising it in the best way.

Someone remarked over in England recently, one of the great statesmen, that the function of a conservative party was to take the wild ideas of radicals, scrutinize them to see what there was in them that was good, and then to make that good work. I think that is a proper function for people in Pennsylvania. Many of the ideas that have been suggested, in my judgment, are admirable. I believe myself that unemployment insurance, old-age pensions, and pensions for the blind are here to stay, and personally I welcome them.

I would like to have seen them come a little more slowly so that we might have accustomed our digestion to them. Candy is good for a child, but you can choke a child with candy if you want to. We have been pretty well choked with the candy that has been given to us.

Nevertheless, those ideas have come. It is our duty to adjust our economic system to these new demands that have been made upon it, find out how much they cost, find out how much they ought to cost—and between those two a great gulf is fixed—find out how they ought to be administered, find out what methods of raising the money can be devised which in the long run will leave the economic fabric of the state as little disturbed as possible.

Those are the problems that we have before us in Pennsylvania, and concerning the solution of which, Mr. President, we will be glad to report at future meetings.

PRESIDENT LESER: In order that the credit which Mr. Edmonds has given to the Pennsylvania Germans may be properly apportioned, it ought to be explained that by the term Pennsylvania German they don't mean a German in Pennsylvania, but they mean one who is descended from Germans who migrated to Pennsylvania before 1730.

MR. EDMONDS: Right. They are the people that dunk the shoo-fly.

PRESIDENT LESER: Exactly. They are also the people that invented the pastime of bundling.

MR. EDMONDS: My recollection is that it was the ones that went to Maryland that did that.

PRESIDENT LESER: I want it also especially noted that my extreme delicacy in handling Mr. Edmonds, and leniency also, should be given due credit, because I do that in spite of the fact that William Penn snatched a lot of territory from Lord Calvert who settled Maryland.

MR. EDMONDS: I told you the Quakers were thrifty.

PRESIDENT LESER: The program permits any discussion anyone may wish to enter into. I might suggest a topic. Mr. Edmonds

has laid great stress upon this wonderful record of not having a debt. He started out by saying that they had no debt. Then he subsequently said, no, they had \$25,000,000, and in the next moment it had jumped up to \$169,000,000. But there may be someone here from Nebraska. I believe the governor of Nebraska told us the other day that they have no debt whatsoever.

MR. EDMONDS: Ohio has no state debt, which would be closer home still.

PRESIDENT LESER: Then there may be people from Wisconsin, or Ohio—

MR. EDMONDS: It is the Pennsylvania German influence going west.

PRESIDENT LESER: — or Nebraska who may want to have something to say.

R. WAYNE NEWTON (Michigan): They were no more thrifty than the Hollanders who settled western Michigan, because although Michigan was known as one of the states that was hardest hit by the depression, the state during the period of the depression added no debt whatever but did add funds to its sinking fund to pay its soldiers' bonus which they did have in the form of a debt, and some highway bond issues which had been issued many years before.

But no dollar was added during all the depression, although no one has ever doubted that welfare was well taken care of in that state.

PRESIDENT LESER: It is generally suspected that Henry Ford shook the change out of his hip pocket.

Is there anyone else who wants to say something? Here is your chance, gentlemen. Brag all you know how.

P. E. WARD (Ohio): I just want to add one statement. Ohio has not had a dollar of state debt. In the years since 1934 to the present time, the debt of the subdivisions has been reduced in the total in the state by more than \$100,000,000.

PRESIDENT LESER: Now we have heard from Ohio and Michigan.

CLARENCE L. TURNER (Pennsylvania): I think Senator Edmonds should be congratulated on his paper. I think it is significant to note in connection with the funds that have been raised for general purposes in Pennsylvania, excluding the funds raised for highway purposes, that they came mainly from two sources, before these new taxes. Business taxes which mainly and almost entirely came from corporations bore 65 per cent, and the inheritance and death taxes accounted for the difference up to 95 per cent.

Then the new taxes that were enacted which Senator Edmonds mentioned—over 50 per cent of those also fell on business. I think

that is very important, very significant, to note that business is bearing the burden in the state of Pennsylvania.

PRESIDENT LESER: I think Mr. Edmonds forgot another thing that might have been mentioned and that was unique in Pennsylvania, that they still adhere to the system of lumping the assessment on real estate, lumping the land with the building.

MR. EDMONDS: Not any more, judge.

PRESIDENT LESER: I am very glad I brought that out, because that vindicates Pennsylvania. They have seen the light.

BRUCE P. TYLER (Virginia): Senator Edmonds has referred in a very delicious manner to the shoo-fly. Everybody may not be familiar with the shoo-fly. Would you kindly ask the senator to define shoo-fly?

MR. EDMONDS: When we next invite you to come to Philadelphia we will see that you get a Pennsylvania German lunch. Shoo-fly is a cake. When you dunk the shoo-fly you dip it in your cup of coffee, and if you have never done it, it is the most delicious thing in the world.

MR. WARD: The gentleman from Pennsylvania just made this statement: that, if I understood him correctly, something like 95 per cent of all these new taxes were taxes on business. I had a theory in my mind that if the tax was upon persons rather than upon business, the persons would pay less in the end for the support of government than they do if it is collected through the process of taxing business.

Every concern that I know anything about produces whatever it manufactures and sells it at a profit above its total cost, and in that total cost is tax cost. In the end the purchaser who buys that article pays not only the tax but the profits on the part of everybody that handles it. I feel that the tax, then, so largely upon business is certainly going in the wrong direction.

PRESIDENT LESER: Let me assure the gentleman that every dollar of tax on property hits the persons who own the property.

The next business before the house is action on the report of the resolutions committee. I will be glad to hear from Chairman Maxwell of that committee.

A. J. MAXWELL (North Carolina): Mr. President, the report of the resolutions committee was submitted to the conference this afternoon. I lodged a motion, too, which I now renew: that the conference adopt the resolutions reported by the conference committee on resolutions.

MR. EDMONDS: May I ask if the chairman will read the resolutions again? I think there are one or two on which there was a desire to have some amendments.

PRESIDENT LESER: Will you kindly read the first resolution, Mr. Chairman?

MR. MAXWELL: RESOLVED, that if the undistributed profits tax is to be continued this conference recommends modification of it at least to the extent of exempting from the additional tax earnings used to reduce indebtedness, to provide for reasonable expansion, or to accumulate surplus to provide reasonable safeguards against insolvency in times of depression.

MR. MATTERS DORF: Mr. President, I feel that there is one point that is omitted in the resolution as presented. I realize, of course, that one of the purposes of the resolution as redrawn is probably to avoid anything which would savor of political complications. But I submit, Mr. President, that one very important point has been omitted, namely, the question of having this tax apply to corporations which have deficits. Some states prohibit the declaration of dividends if a deficit exists. Other states have no such prohibition. But I feel that it is only just if any amendment be passed to the law by congress, that it omit the tax, or rather not have the tax fall on any corporation which has a deficit, so that there will be equality throughout the states of the union.

I therefore move that there be added to the resolution the following: "And it is further recommended that relief from the tax be provided in the cases of corporations which have deficits."

MR. EDMONDS: Mr. President, I second that amendment. I hope very much Mr. Maxwell and his committee can see their way clear to accept it.

PRESIDENT LESER: I will ask Mr. Maxwell to explain. I think the idea is taken care of.

MR. MAXWELL: I will, of course, be glad to say that whatever action this conference sees fit to take on this matter will be entirely satisfactory to me.

I cannot, however, agree to approve the amendment submitted, because, in my judgment, it is entirely unnecessary and is completely covered by the language of the resolution presented by the resolutions committee. When this resolution recommends that if the undistributed profits tax is to be continued, that there be an exemption from the additional tax, on undistributed earnings, to accumulate surplus, to provide reasonable safeguards against insolvency in times of depression, I fail to understand why that does not fully protect a corporation which has a deficit instead of a surplus. It seems to me that it is just as clearly and fully covered by the

language of the resolution as if the additional language were added to it.

SIMEON E. LELAND (Illinois): I would like to differ with the learned chairman of the resolutions committee, in doubting whether the amendment as suggested is covered in the original resolution. The very fact that there may be some reasonable doubts as to whether it is covered or whether the enumerated exception of the resolution is inclusive of all the things about the corporate surplus tax that need amendment, is to me a matter of rather grave doubt.

Almost everyone that I know of who believes in the fundamental purposes of corporate surplus taxation joins with those who oppose such taxation in condemning the particular act which is now in effect.

It seems to me that it is rather poor policy for this conference to go on record opposing the current legislation and current tax practice of the federal government without a thorough and constructive analysis of federal laws and federal taxes and federal practices.

While it may be technically true that the resolution as presented comes within the rules governing the conference, requiring a resolution either to have been the subject of a committee report or the subject of discussion at a previous conference, it is none the less true that it neither is covered by a report of a previous committee, nor were these particular points specifically discussed except as they arose out of discussion of individual presentations of the defects of the corporate surplus tax.

It seems to me that if we want to commit this conference in a constructive way toward improving federal tax policy, that it is a far better course to request the association to appoint a committee to investigate this subject and make a report on it than it is to simply resolve in a rather half-baked fashion some of the things that most of us don't like about this particular tax.

I would rather see the conference request the association to appoint a committee to investigate and report on the corporate surplus tax and related problems, and federal corporate taxation, and to make a thorough-going and constructive report on the subject than to simply join in the current volume of discussion in condemnation of a tax which so many of the members happen to dislike.

PRESIDENT LESER: Are there any further remarks?

MR. MATTERSDORF: May I have the floor again?

With respect to the statement of the chairman of the resolutions committee, may I say that I being an accountant, cannot quite agree that the accumulation of surplus and the taking care of deficits are quite the same thing.

A corporation may have a surplus, and may legitimately earn more money, and should earn more money and set part of that aside

for its future use. I do not believe that the words in the resolution as it now stands cover the other situation which exists when there is a deficit.

PRESIDENT LESER: If I could be permitted to say a word, I think there is a defect in your amendment, and that is that you excuse all corporations that show a deficit. Suppose a corporation has an impairment of \$10,000 in its capital; supposing in the next year it has made profits of \$20,000. Why shouldn't it be subject to this tax, at least to the extent of the excess of those earnings over the deficit?

MR. MATTERS DORF: Yes, sir, I will accept an amendment to my motion.

J. W. OLIVER (New York): I am inclined to agree with Professor Leland on this whole subject. I am in sympathy with the accountant, but I have given this a great deal of thought and I think that so long as we try to patch up an act that has two opposing theories in it, which this act does, if you are going to exempt corporations from taxation altogether provided they pay their dividends, then you have the proper theory or the proper approach to this matter, though it might have administrative difficulties beyond reason.

But so long as you have a corporate tax by which you are taxing the corporation as a separate entity and then through the distribution, or forcing distribution, you are trying to reason that this corporation is not a taxable entity but the individual should be the taxable entity, you have two commingling theories there that will never work. I would much rather see a committee appointed to investigate thoroughly the corporate surplus tax rather than to try to patch up something we all admit is not good.

We may oppose it from the standpoint of the way it was originally introduced, or we may oppose it in its present form, but this patchwork will not cure the defects or the opposition that both sides of us have against that particular act.

MR. EDMONDS: Mr. President, you recall that when Mr. Alvord was speaking the other night he directed attention to the fact that a part of the authority in support of the act was supposed to be the National Tax Association. That is one of the reasons why it seems to me that a resolution on this subject is appropriate at this time. We had it considered on both sides at Indianapolis, and we have also had argument on it here.

I think that it is very important that the conclusions of this conference should come with a substantial degree of unanimity, in order that they may have the weight that they should have when they are presented at other places, and if the amendment that my friend has introduced is likely to cause any particular controversy, I think

both my friend and I would favor having the report of the committee adopted rather than silence on the subject.

This seems to me to be a bit unusual. I am perfectly willing that there should be a committee appointed, and I think it would be a fine thing, to study the principle of the corporate undistributed profits tax to precede a report later on. But in the meantime the question of the amendment of that act coming up and we are quoted as in favor of it, it seems to me as if that quotation doesn't represent our point of view, we are justified in making our point of view clear, as is done to a certain extent by the resolution of the committee.

MR. LELAND: I would like to inquire, as a matter of information, by what right anyone quotes the association as being in favor of the corporate surplus tax last year? You can get misquoted very easily. But if you will examine the proceedings of the conferences, both last year and theretofore, you will find not an iota of evidence showing that the conferences resolved either in favor of or opposed to it. What we had last year was an address by Mr. Godfrey Nelson on this particular tax, in which he discussed its defects. We had another one by Mr. Alvord expressing his own individual point of view. We had a discussion from the floor on both of those papers and nothing more.

It seems to me that instead of joining the bandwagon of the businessmen opposing the tax, that it is much better, Senator Edmonds, for the deliberations of this body to assume a character of something more than mere expression of opinion, that we ought to consider the matter carefully and have some constructive statements, not merely about the matter of corporate surplus taxation, but the whole general framework and policy of corporate taxation in general, which must be examined if corporate surplus taxation is to be discussed at all.

I think Mr. Oliver is quite right, and I would like to move that—I don't know whether my motion is in order or not—instead of adopting the resolution read, that we substitute therefor a resolution requesting the National Tax Association to create a committee to investigate and make a report on the subject of federal taxation of corporations.

MR. TURNER: As I understand the quotations that have been made with reference to the National Tax Association, they are statements that were supposed to have been made in 1920 in the first instance and 1927 in the second, and they did not refer to the discussion that went on this year or last year.

MR. LELAND: Then they are out of point. They have nothing to do with this tax at all.

MR. TURNER: As I understand the situation, the ones who are advocating this surtax on corporate surplus are naturally looking for some support wherever they can find it, and they have chosen to pick up some language from statements that have been issued by officers of this association sometime ago.

Now while I am on the floor I would like to ask Mr. Leland, if such a committee would be appointed as he suggested, when would that committee report? The reason I ask that question is that the treasury department, the joint congressional committee, and the house ways and means committee are working on a revision of the 1936 act which they expect to present at the next regular session of congress.

I happen to be a member of the federal tax committee of the American Institute of Economists, and our committee has been in touch with the treasury officials and with the house ways and means committee. I know they are quite anxious to get all the material in their hands as soon as possible. They have asked us to submit a further report, which they want in their hands by November 4, which, I believe, is the first day that the house ways and means committee is going to hold public hearings, although I don't presume that that would be the last day to get material in on the matter.

So if you let it go, postpone action until next year, I don't know what will be the result in so far as legislation is concerned, whether the tax will be in the new act or whether it will not be in the new act. But I think that the association ought to take some stand on this tax if they are not in favor of it. If they are in favor of it, let them take whatever action they see fit along those lines, but I think they ought to do something about it because it is a current topic, not only in tax circles but in business circles, accounting circles and legal circles.

The American Bar Association has given quite a lot of time and study to it. The American Institute of Accountants have done so. The American Management Association and many other associations of that kind have studied it. I don't see how we as an association can sit by and see it stand on the statutes as it is now.

HENRY F. LONG (Massachusetts): Mr. Chairman, this indicates the kind of difficulty that we are frequently in. Many in this room are not now differentiating between the National Tax Conference and the National Tax Association. The words as used by Mr. Alvord and the words that have been expressed here tonight indicate that the National Tax Association is doing something either in acceptance or rejection of a resolution phrased as the resolutions committee has reported it or to in some manner amend it to suit the various suggestions and thoughts of the delegates here assembled.

The National Tax Association in its thirty years of existence has consistently through all those years kept, as far as possible, away

from controversial subjects. Therefore, it seems to me wise that we who are interested in the continuity of the National Tax Association, in the continuance of tax conferences, consider dispassionately any of the proposals which may be directed toward any kind of public finance, without any entanglements by conclusions reached in those conferences which may be distressing. We are in essence an open forum. We are not crusading for any particular objective. We are not setting ourselves up as those who know all that there is to know, and that congress should follow a suggestion that we make, or that we can, merely by resolving at a conference of this nature, do something that should be done with a federal proposal that will ultimately cure all the difficulties that might be encountered in the operation of this particular tax act.

The National Tax Conference, if this proposal is passed, will lose, so far as press comment is concerned, its identity, and it will be said that the National Tax Association has made this proposal. Suppose the National Tax Association makes the proposal and the federal congress does not follow the suggestion. Does that leave the National Tax Conference, or the National Tax Association, its sponsor, in the position that we want always to keep ourselves, namely, aloof from anything which may be of a controversial nature?

It is true that we have suggested in our conferences from time to time a study through appropriate committees of a problem which indicated that there was an opportunity for study and research. But there are sufficient already in the field such bodies as the accountants' and others, who have a definite objective and who can very well emphasize the public opinion as voiced through the people who are perhaps more or less generally represented in this conference.

Irrespective of the merits or the grammar or the objectives or any of the other things in this resolution, and with the deeper underlying purpose of keeping the National Tax Conference, and the National Tax Association, which has a very narrow line of separation in the minds of many people, clear from what appears to me to be a difficult and controversial question, I move you, Mr. Chairman, that the resolution be not adopted and that it be discarded by vote of this conference.

PRESIDENT LESER: The immediate question before us, of course, is the amendment offered by Mr. Mattersdorf of New York to the resolution as reported.

MR. MATTERSDORF: Mr. President, I don't think that the controversy should arise over the amendment. Frankly, I think the controversy goes to the resolution. My amendment—and I want to get it in the record—was merely intended to clarify some of the language and merely to bring out a point I personally felt should be in there.

It was not intended to be in any way controversial, and I would like to let it stand merely as an amendment to the resolution and let the resolution stand on its own feet with or without the amendment.

SECRETARY W. G. QUERY: I want to call attention to the rules adopted at the first session. If a vote is ordered on this question it will be necessary to confine the voting on the question to delegates who have been duly appointed by governors in accordance with article II, section 3 of the by-laws, which reads: "the voting power in each conference upon a question of taxation or public finance of general public interest shall be vested in the delegates in attendance appointed by the governor or other chief executive of the states. In voting upon such questions each state shall have one vote, and in case of a division of opinion among the delegates therefrom, the vote shall be divided, so as to give proportional weight, by approximate fractions, to the opinions of the respective delegates."

It will be necessary for the credentials committee to check those who are going to vote on this matter.

MR. MATTERS DORF: I will withdraw the amendment, Mr. President.

MR. LELAND: I move you, Mr. President, that there be presented to the conference a substitute resolution requesting the National Tax Association to appoint a committee to study and investigate the subject of the federal taxation of corporations and to make a report on this subject at the next regular meeting.

E. W. MCGREW (New York): I second it.

MR. MAXWELL: May I be recognized for a further brief statement?

The situation your resolutions committee had before it was that it had three resolutions from the floor, each one of them condemning unconditionally and without reservation the undistributed profits tax. It was the purpose and the effort of your committee on resolutions to reconcile conflicting views on this subject in a manner that would not be inconsistent with the traditions of the National Tax Association at conferences sponsored by it over a period of thirty years.

The situation we had was that congress, something like a year ago, undertook a new experiment in the field of federal taxation. I don't think we are prepared to say—I am not prepared to say—that no part of that statute has any place in the fiscal policy of this country. I am not prepared to say that there are not situations where closely held corporations whose owners are subject to income tax in the highest brackets prefer to have the income of those corporations retained in the corporate treasury for the very purpose of evading the payment of a tax that they in good conscience ought to pay.

What this resolution does undertake to do, and all that it undertakes to do, is to recommend for consideration by congress that if the undistributed profits tax is to be continued that it be modified in the three major respects that have been most criticized in the public press by tax authorities, and that have perhaps had the most unfavorable effect on the business policy of industrial and business corporations. Those leaders who originally sponsored this statute have been repeatedly quoted in the public press as being open-minded for consideration of its defects after this year of experience under it.

After that statement, Mr. President, any action this conference sees fit to take about it will of course be satisfactory to me.

MR. EDMONDS: Mr. President, I agree with the chairman of the resolutions committee. I should have been glad to have accepted the amendment added because I think the efforts to which the amendment directed attention are of equal quality with those that have been mentioned. But I do think it is important that if we have a feeling on this subject we should press that feeling.

This is one of the measures which is under consideration now. It will be under consideration for the next three or four months. A committee of the National Tax Association, if the association should appoint such a committee, would report next year, probably in October, and during that period the association would, I think, rest under a sort of an imputation that some of its leaders ten or fifteen years ago had advised this particular kind of taxation.

I agree that it is very important for us to maintain the catholicity of our national tax conferences, but I do not see how we can perform the work that the public expects of us and at the same time take no stand upon controversial tax questions. It is upon those questions that the public looks to this body for advice, and if it should turn out that our advice is in favor of the resolution as Chairman Maxwell has reported it, I think we ought to say so.

After all, we have to recognize that a great deal of this taxing legislation has been experimental. Nobody knew exactly what was going to happen when they passed these kinds of laws. Now, after a year's experience, it is possible to collect some information on the subject.

I would like to see Mr. Leland's committee appointed by all means, but I would also like to see the Maxwell resolution adopted.

MR. LONG: Mr. Chairman, I think that Senator Edmonds overlooks the fact that the conference here gathered is undertaking to pass, or to consider for passage, a resolution which has nothing by way of support in the nature of study or deliberation by the conference or by a committee of the National Tax Association.

Whatever feeling we may have in respect to the undistributed profits tax is something that we have developed out of our own experience, our individual thought without the benefit of collective conferences with others who may have an entirely different feeling. It would have probably been the wiser course in last year's conference to have appointed a committee to study this particular problem. It would have been perhaps far better to have made some effort two years ago, before the Indianapolis conference, by appointing a committee to consider it.

The mere incidence of the late lamented President Thomas S. Adams and perhaps others making a suggestion along this line, which may not have been seriously advanced, but only suggested as something which developed from academic thought, as something we should correct, is not the sort of a thing which it seems to me we should personally put ourselves in the position of recognizing by passing a resolution of this kind.

Because it is a halfway measure, and it is my guess that the coming congress is not going to make the change in the law that some of you anticipate, a committee considering it for a year should not be considered as a delay beyond the point where something definite can be done.

If there are any three persons in this room who can say that they collectively have given a great deal of study to this particular subject, its application, what changes might be made in it, what place it should have in a tax structure, and can give us a report now as to what their deliberations are, I should be very glad to act on that particular report that they make. But my understanding is that no one can do that, and I am not willing to vote for this resolution or put the tax conference, or by implication the National Tax Association, in this position merely because we have some individual thoughts as to what should be done.

However, I think the parliamentary procedure is relatively unimportant. There could be a motion made to lay it on the table. There could be a motion made to take these amendments on. There could be a motion made to appoint a committee. Or the resolution can be rejected on the underlying theory which I think should always control us, that we as a body have not investigated it and we are not in a position to pass intelligently upon it. It is an opportunity to save ourselves, it seems to me, a great deal of embarrassment.

MR. LELAND: Mr. President, I don't want to speak continuously on this matter. And I didn't realize that I was going to stir up so much interest and discussion. But I want to emphasize what Mr. Long has just said and make my own position clear with reference to these three or four points in this resolution.

I am in agreement, I think, in substance with practically all of the amendments that they suggest to the corporate surplus tax, but that is not the question. That has nothing to do with the issue at all; whether we like it or whether we don't like it is absolutely beside the point.

There has been no problem in federal taxation which is more important or more controversial than the subject of corporate taxation at the present time. Here is this conference supposed to be composed of tax students and tax scholars adopting a resolution without any study, without any investigation, without any information, without any supporting data, without any consideration of the merits of this proposal. The nearest parallel we have to this goes back to 1926 when the continuation of the federal estate tax was in issue. At that time an effort was made to commit the conference to a resolution and a statement of policy that would have been embarrassing. I think that a good part of the confusion in the minds of people here tonight with reference to 1920 and subsequent years is with reference to excess profits taxation and not to the taxation of the corporate surplus as it is today and as it is proposed.

It seems to me that it is very unfortunate for us to hasten a thing of this kind and to put through a resolution simply because there is a general stampede on congress for a change in the act. While it may be very helpful to get a chance to have our feeble voice added to it, it doesn't seem to me that we are conducting ourselves with the kind of decorum or in conformity with the traditions of the National Tax Association when we allow ourselves to be stampeded into the adoption of a resolution condemning the things which we may not like, without having this thoroughly investigated and having the whole general subject of federal corporate taxes brought clearly before the next conference.

ROY E. WALWORTH (New York): I have attended three of these tax conferences, once as a visitor and twice as an official delegate. I have heard a lot of talking. It seems to me that the time has come for some action. According to Mr. Leland, if we have a patient at the point of death we should start making a case history of his life to decide what to do.

This vote is coming up in congress for an amendment. If we delay the thing, we are taking the position that we haven't the courage of our convictions, we wish to keep in the background and see what congress is going to do.

I move the resolution be put to a vote.

LEWIS B. COOPER (Texas): The question before the house is the substitute resolution offered by Mr. Leland, and it has been seconded.. It seems to me that Mr. Leland has presented a very important point of view that we should consider very carefully when we vote on that motion.

MR. OLIVER: May I just add one word?

As I understand Professor Leland, this committee would report on the appropriate taxation for a corporation regardless of what congress may do. They may completely repeal it and this committee would still consider whether or not the corporation should be taxed, how it should be taxed, and what is the proper basis for corporate taxation.

MR. EDMONDS: I would like to vote for Dr. Leland's motion. I think it would be a very good thing to have a committee of that type appointed. I would also like to vote on Mr. Maxwell's resolution. I don't think Mr. Leland's resolution ought to be put in as a substitute.

There have been precedents. I will call his attention to one. The New Orleans conference in 1925 endorsed reciprocity before the National Tax Association appointed its committee on reciprocity.

MR. LELAND: That was a gross mistake.

MR. EDMONDS: It is a precedent.

What I would like to see done is to have the Leland resolution and the Maxwell resolution put separately. I move that the vote on these two resolutions be taken separately and not on one as a substitute for the other.

PRESIDENT LESER: Mr. Leland, are you satisfied to put your resolution as a separate resolution rather than as a substitute so that we may have a vote on it and then have a vote on the resolution?

MR. LELAND: You ought to defeat this resolution with reference to the suggestion that congress make these changes in the corporate surplus tax, and then adopt my resolution, if that is the way you want to do it.

I don't care how it is done. I am no parliamentarian, but it seems to me, as Mr. Long says, it is a gross mistake to commit us to matters of legislative policy without investigation, without research, and without mature deliberation.

HARLEY L. LUTZ (New Jersey): I think the conference ought to understand one matter which hasn't been brought before it as yet. It is a subject that will come up in the business meeting, but it has a direct bearing on the situation before us at this time.

I learned just recently through Mr. Holcomb that the association is in a jam with the internal revenue department, because of the question of the applicability of certain phrases in recent revenue acts relative to the exemption of contributions and the like, in case they are given to organizations which are indulging primarily in propaganda.

If we take the sort of action that seems to be favored here tonight, are we strengthening our case that the officers of the association are trying to make before the commissioner with respect to the status of this association?

The articles of the association assert in the plainest words that it is an organization established for study and research; in other words, that it is essentially a scientific organization. A scientific organization does not proceed on impulse or emotion or any other basis than that of careful consideration of the facts.

I am sure that we are in 100 per cent agreement with respect to the particular subject matter of these resolutions. But as Mr. Leland and others have pointed out, we are in agreement either out of individual experiences which are not of scientific value unless they are properly collated and interpreted or out of our emotional reactions.

Are we not, therefore, in acting as some seem to favor on this subject at this time without any more consideration than has been given to this important subject, in danger of jeopardizing the position of the association on a matter that might be very vital with respect to its whole financial future?

You might say that the problem is such that we can afford to jeopardize that future, but I don't think it is that urgent, and it seems to me that the conference would be exceedingly well advised, therefore, if we were to proceed along the entirely reasonable and sensible and, after all, the only scientific line of approach that Mr. Leland has suggested, namely, of studying the subject, and after we have studied it and have the benefit of a careful and thorough consideration of all angles of the question, then we can formulate a resolution based upon those findings, and that any scientific procedure would entitle us to do.

But if we act now, largely on the basis of our emotions or our feelings or our adverse personal experiences or repressions, are we not confirming the contention that the bureau of internal revenue has already evinced, namely, that we are a propaganda organization and not a scientific organization?

I suggest that you bear that point in mind, gentlemen, in voting on these questions.

JAMES L. SAYLER (Illinois): May I make a statement?

I think the resolutions committee has been faced with considerable difficulty due to the fact that there were three resolutions presented, and it has been faced with the problem of somehow getting to the meat of the thing as viewed in the light of three different people.

It seems to me that in view of the situation that exists that it would be better if the committee would study this, and I would be in favor also of a little more accurate wording. I am sympathetic to all the objections, but I think that in a logical presentation there should be first a setup of certain things and then the conclusions, and I think that can only be done by a study by a committee appointed by the association. I, therefore, am in favor of Mr. Leland's resolution.

PRESIDENT LESER: Have you some remarks, Mr. Edmonds?

MR. EDMONDS: No, I wanted to say simply that I thought we had better get to a vote.

I sympathize with what Mr. Lutz has presented. For my own part, however, the National Tax Association receives very few contributions in the way of gifts for its work, and my own private opinion is that I would rather pay a tax upon them than lose the opportunity to express my opinion on what I regard as a very great and important question.

PRESIDENT LESER: To get out of this parliamentary tangle, is it agreeable, Mr. Leland, if we take a vote on the committee resolution—

SECRETARY W. G. QUERY: Mr. Chairman, then we have to get the credentials committee busy and find out who can vote. You should order a vote on the motion of Mr. Leland to substitute his resolution for the committee resolution. The amendment by Mr. Mattersdorf was withdrawn and the question before us is the motion of Mr. Leland.

PRESIDENT LESER: Let us first find out—

SECRETARY W. G. QUERY: You can't vote on the committee resolution except by states.

PRESIDENT LESER: I think we can test the sentiment first.

MR. LONG: That, I think, should be made clear. As I understand it, using a concrete example, the New York delegates appointed by the governor will have to confer together and vote as a unit.

SECRETARY W. G. QUERY: Every state will have to do likewise.

MR. LONG: Therefore, we should have the New York delegation now retire and decide how they are going to vote. All the rest can do a similar piece of work and we can plan on staying here over the weekend.

SECRETARY W. G. QUERY: And those states which have not duly appointed delegates cannot vote at all.

MR. OLIVER: I suggest that we find out if there is substantial agreement here as to what is to be done.

MR. MCGREW: Is Mr. Maxwell's resolution now before the conference, or Mr. Maxwell's resolution as amended?

PRESIDENT LESER: Mr. Maxwell's resolution.

My idea is to take a vote first to see whether there is any substantial apparent division.

MR. TERRY: I move we take a recess for five minutes so that the various state delegations can go into a huddle and report.

PRESIDENT LESER: Is that motion seconded?

(The motion was duly seconded)

PRESIDENT LESER: Gentlemen, it is moved and seconded that we take a recess of five minutes to allow the delegations to test out their sentiments.

(A short recess was taken)

PRESIDENT LESER: The meeting will come to order.
I recognize Mr. Leland.

MR. LELAND: As a substitute for the resolution offered by the resolutions committee, I renew my motion for the adoption of the following resolution:

RESOLVED, that the thirtieth annual National Tax Conference request the National Tax Association to appoint a committee to investigate and report at the next annual conference upon the federal taxation of corporations, including the taxation of undistributed corporate profits.

(The motion was duly seconded)

PRESIDENT LESER: The motion has been seconded.

Gentlemen, this vote will not require a vote by units of states but a vote by all in attendance.

I therefore will put the motion and ask those who favor it to raise their hands. The motion before the house is to adopt Mr. Leland's resolution as a substitute for the resolution of the resolutions committee. As many as favor the motion, raise their hands. Will the secretary please count the votes?

SECRETARY W. G. QUERY: Twenty, Mr. President.

PRESIDENT LESER: Those opposed to the substitution of Mr. Leland's resolution will raise their hands.

SECRETARY W. G. QUERY: Ten, Mr. President.

PRESIDENT LESER: The vote is twenty to ten in favor of Mr. Leland's resolution and I pronounce it adopted.

We may proceed now to the next recommendation of the resolutions committee.

MR. TURNER: What was the result of the other one?

PRESIDENT LESER: The adoption of the substitute resolution was voted twenty to ten.

MR. TURNER: Hasn't the rule been a four-fifths vote instead of two-thirds?

SECRETARY W. G. QUERY: The four-fifths vote rule referred to by Mr. Turner, contained in the rules of procedure adopted at the first session of this conference, applies only when a vote is taken on any question or matter involving an expression of the opinion of the conference upon a question of taxation or public finance. The vote just declared was upon a substitute resolution providing for the creation of a committee therefore the four-fifths vote rule did not apply.

PRESIDENT LESER: It didn't require a four-fifths vote and it didn't require a vote by states.

MR. MAXWELL: Mr. Chairman, I don't think there will be any controversy about the other resolutions, and before proceeding to read them, may I say that I am reminded of an observation made by a gentleman down in my state some years ago when they were shooting a cross-fire of embarrassing questions at him. He said, "You can't embarrass me. I voted for Al Smith."

PRESIDENT LESER: Did you notice the gentleman from South Carolina helping the gentleman from North Carolina to a glass of water?

To such have we become, gentlemen.

MR. MAXWELL: RESOLVED, that this conference request the National Tax Association to appoint a committee to give further consideration to the question of allocation of income for state income tax, in the hope that further progress may be made in the direction

of uniform legislation and administrative practice, and to promote comity between the states in income tax administration.

MR. LONG: I move the adoption of the resolution.

PRESIDENT LESER: Gentlemen, you have heard the motion and the text of the resolution. As many as are in favor will kindly signify by saying, aye.

(Ayes)

PRESIDENT LESER: Opposed, no.

(None)

PRESIDENT LESER: It is unanimously carried.
Now then, the next one.

MR. MAXWELL: RESOLVED, that the conference recommend to the National Tax Association the continuance of the committee on property tax limitation and homestead exemption.

MR. LONG: I move its adoption.

PRESIDENT LESER: It has been moved and seconded that this resolution just read be adopted. As many as favor that say, aye.

(Ayes)

PRESIDENT LESER: Opposed, no.

(None)

PRESIDENT LESER: There is a sweet unanimity on that.

MR. MAXWELL: RESOLVED, that this conference hereby request the National Tax Association to appoint a committee to consider the question of the taxation of capital gains by the federal and state governments.

Was that your resolution, Mr. Long?

MR. LONG: In that one I would like to strike out, if I could, the words "and state" and add the words "and to make such further inquiries as they deem advisable," so the committee will confine its investigation to the taxation of capital gains by the federal government and not get mixed up with the fourteen different varieties of state taxation.

MR. MAXWELL: The committee added the words "and state," with the thought that it would be advisable to investigate both of

these fields. Mr. Long, the author of the resolution, thinks that is covering too much territory.

MR. LONG: Mr. Chairman, the committee will have all they can do in considering the federal end of it, and by concentrating their thought on one thing will make a better report. By taking out the word "state" and allowing the committee to make such other investigation in connection therewith as deemed advisable, will still permit them to go into state investigation if they desire, but they are not compelled to by the resolution.

MR. MAXWELL: Again I say, if the conference sees fit to adopt the amendment, it will not embarrass the chairman of the resolutions committee.

PRESIDENT LESER: Is the amendment seconded?

(The amendment was duly seconded)

PRESIDENT LESER: The resolution as amended is before the house. As many as favor that will say, aye.

(Ayes)

PRESIDENT LESER: Opposed, no.

(None)

PRESIDENT LESER: The ayes have it and the resolution will be redrafted to accord with amendment.

MR. MAXWELL: RESOLVED, that this conference request the National Tax Association to continue the committee on double domicile in inheritance taxation.

PRESIDENT LESER: As many as favor that say, aye.

(Ayes)

PRESIDENT LESER: Opposed, no.

(None)

PRESIDENT LESER: It is a vote.

MR. MAXWELL: RESOLVED, that the thirtieth annual conference on taxation expresses its high appreciation to those in charge of arranging for the accommodation and entertainment of its delegates and guests and particularly thanks all those participating in the program with contributions which evidence painstaking and studied efforts and are a distinct contribution to current tax literature.

PRESIDENT LESER: Is that seconded?

MR. LONG: I move it be adopted.

PRESIDENT LESER: Without inviting any acrimonious debate on that resolution, or asking the delegations to get into a huddle, I will put that. As many as favor that say, aye.

(Ayes)

PRESIDENT LESER: Opposed, no.

(None)

PRESIDENT LESER: The ayes have it.

The next order of business, under the head of "Miscellaneous Matters" gives an opportunity for a brief—accent on the brief—representation of the claims of the various localities that would like to have the next conference. Two minutes is Mr. Query's edict.

Is there anyone who wants this conference to meet next year anywhere? (Laughter)

R. WAYNE NEWTON (Michigan): I hesitate to take up two minutes at this time to tell this conference about the advantages of the state of Michigan, or perhaps of the city of Detroit. I think that they should be well known to you by now. I have been telling you for ten years, and as yet this conference has never been to that great state where the automobiles are made, never been where the wives go to Greenfield Village, never enjoyed our recreational facilities or the advantages of one of the greatest convention cities in the United States.

We are not making an effort to bring the conference there, however, in that sense, but because we believe it will be of tremendous value to us both to have you there and to you as tax officials to observe the methods of taxation and assessment followed there, and to see something of the type of property that we have to deal with. Many of the problems that you have at home are similar to those in Michigan.

I have extended this invitation, I believe, from Seattle all the way around, and we have come in several times in second place. I hope this time we can be in first place, and I hope we can meet you there next year.

Thank you.

PRESIDENT LESER: Let me use a word of caution as I did, I think, a year ago, to warn gentlemen who are recommending cities not to put it on too thick about the diversions, because we meet at these conferences for business.

Is there anyone else?

LEWIS B. COOPER (Texas): I thought there would be a couple of secretaries of chambers of commerce here who would give you an oration and invitation, but they haven't arrived.

So as one of you, I want to say that we would like to have this conference in Texas, not to entertain you—we could do that—but because you are a working conference. Our tax structure in Texas needs you, and we feel that you will do us more good than we can do you.

But if you come down there I promise you that we will give you as large an audience as any to which you can make your reports and addresses, because we feel that this type of educational program for the public is highly desirable. For that reason I would like to see this conference come to Texas. We will pledge you from 200 to 300 new members, or as many members as any state has ever had, if you can come. We will welcome you.

PRESIDENT LESER: Is there anyone else?

GEORGE HETHERINGTON (Colorado): The Honorable Teller Ammons, governor of Colorado, has authorized me to invite you to hold your next conference in the city of Denver.

Denver is a convention city. They know how to take care of people. They have hotels and auditoriums where they can accommodate you adequately and so that you will be satisfied with the conditions there. We have a climate which is conducive to just the kind of work that this conference does.

I am quite sure that you will find, as we say in Colorado, that it is a privilege to live in Colorado, and if you come to Denver you will say, "Well, it has been a privilege to have had our conference in the city of Denver."

PRESIDENT LESER: I want to remind the gentleman that apparently he goes on the theory that one good turn deserves another, because we met in Denver in 1914. But the gentleman was probably too young to remember that.

Are there any other cities that want to be heard?

W. H. BUCKINGHAM (Nebraska): I was delegated by the governor of Nebraska to ask that the conference give consideration to Omaha as a place of meeting for 1938. I am quite certain that we have everything to offer you in the way of accessibility and hospitality, and I think it would be a good place to hold a conference.

WARREN RAGGIO (Louisiana): I would like to have about twenty minutes, because I have a long speech I want to give, but since I have two minutes I will try to give it in two minutes.

I come from the Creole state of Louisiana and also from the most wonderful city of its kind in America, in other words, the Paris of America. I could make a real estate talk, but you won't give me the time so I won't do that, so I am going to appeal to these learned gentlemen here on two grounds. First, we have the facilities to entertain the conference. We have two of the finest universities in the United States. We have learned doctors and educators in both those universities.

We have the finest capitol building in America, in which some of the state officials are very dignified gentlemen, excluding myself.

The next group I am going to appeal to—you know it is said that the hand that rocks the cradle rules the world—is the ladies,

if I may. We have in Louisiana every kind of enjoyment that the ladies might wish. We have the most beautiful street, Canal Street, in America. We have the quaintest old French quarter on the North American continent. We have a town from which radiates these expressions: southern hospitality and southern chivalry. We have them both there.

We have, in my opinion, the finest state in the world, in which is located the largest sulphur mine in the world. Believe it or not, more fur which is on these beautiful ladies' coats comes from Louisiana than the entire Dominion of Canada. We also have the finest oysters in the world and they are served on the half-shell at fifteen cents per dozen.

We also have what is known in our Creole state as courtbullion, crayfish bisque; we have coffee eaulay and coffee noir. Also, for the gentlemen we have the famous Ramos gin fiz.

SECRETARY W. G. QUERY: Mr. Chairman, in addition to the invitations that have been extended here from the floor the secretary has invitations from San Francisco, Los Angeles, Minneapolis, St. Paul, St. Louis, New York, Cincinnati, Columbus, Oklahoma City, Pittsburgh, Nashville and Memphis.

We will not lack for places to go. All of these invitations will be placed before the executive committee at the proper time.

PRESIDENT LESER: It looks to me as if the committee might compromise afterwards by having each state delegation meet in its own state.

The next business is a very important motion, namely, to adjourn this conference.

CLARENCE L. TURNER (Pennsylvania): I would like to make that motion, but before doing it I would like to make a suggestion, if you will, that the committee might consider in connection with the meeting next year the matter of the dates. It so happened the last three years that the conference has been held during the week that the American Institute of Certified Public Accountants have held their annual meeting, and there are quite a few of the members of that institute who would like to be able to attend these conferences. This year they missed it by a week. Last week we were in New York at the American Institute of Accountants and as a result are able to be here this week.

Won't you please confer with the secretary of the institute in order to find out what dates they are going to have their meeting and see if we can't get together on the proposition?

PRESIDENT LESER: That could be very easily adjusted by having the accountants meet at some time other than at the time of our meeting.

Gentlemen, I will entertain the motion I mentioned awhile ago.

E. W. MCGREW (New York): I make the motion we adjourn, Mr. President.

PRESIDENT LESER: The motion is solemnly put.

(The motion was duly seconded)

PRESIDENT LESER: This will not be voted on by state delegations. It is moved and seconded that we adjourn this conference, but not the association, gentlemen. As many as favor that will say, aye.

(Ayes)

PRESIDENT LESER: Opposed, no.

(None)

ANNUAL MEETING OF THE NATIONAL TAX ASSOCIATION

THURSDAY, OCTOBER 28, 1937, 10:30 P. M.

PRESIDENT LESER, presiding.

PRESIDENT LESER: We now will open the annual meeting of the National Tax Association. There is no need for anyone to leave because they may not be members of the association. We are always in hopes that they will realize the benefits of joining.

I am now going to ask the secretary if there is a quorum present.

SECRETARY W. G. QUERY: There is a quorum present.

PRESIDENT LESER: I will now ask the secretary to read the call for this meeting, because the by-laws require that there shall be a call issued sixty days before.

SECRETARY W. G. QUERY: The call for the meeting of the National Tax Association tonight was contained in *The Bulletin*, June, 1937, and is as follows:

" NOTICE OF ANNUAL MEETING OF THE NATIONAL TAX ASSOCIATION

" To Members of the National Tax Association:

" Pursuant to the provisions of section 1 of article III of the by-laws, notice is hereby given that the annual meeting of the National Tax Association for the election of officers, three members of the executive committee, and such additional members as may be necessary to fill vacancies, two honorary members of such committee from residents of Canada, and to transact such other business as may properly be transacted at such meeting, will be held at the Lord Baltimore Hotel, Baltimore, Maryland, on Thursday, October 28, 1937, immediately at the close of the thirteenth session of the thirtieth national tax conference. Attest, W. G. Query, secretary, Columbia, South Carolina, June 13, 1937."

PRESIDENT LESER: The next business in order is the report of the secretary.

SECRETARY W. G. QUERY: Mr. Chairman, it is brief, and I am not going to keep you here much longer as far as I am concerned.

REPORT OF SECRETARY W. G. QUERY

In addition to the numerous details in connection with the annual conferences for the years 1936 and 1937, the secretary's duties regarding membership, sales of publications, and general correspondence have been voluminous and exacting.

It is gratifying to know that delinquency in the payment of annual dues has decreased and that membership is gradually increasing. On July 1, 1935, more than 200 members were delinquent in the payment of dues, and of such number 81 were finally cancelled for non-payment. On July 1, 1936 there were 47 delinquent memberships, of which 33 were cancelled. For the period ending June 30, 1937, 24 members are delinquent.

During the year ending June 30, 1937 we enrolled approximately 100 new members, which gives us a net gain of 67 members over the previous year. The increase of 100 new members during the past fiscal year consisted of 40 new members secured at the Indianapolis conference, and the balance was scattered throughout the year. Solicitation of membership by two or three members of the executive committee has produced good results, and it is evident that the membership can be materially increased if concerted action is taken by those interested in the affairs of the association.

Wide interest is still being shown in the publications of the association, especially the back volumes, but sales of back volumes have not increased over sales of previous years.

The above is my official report for the fiscal year, but I want to state that at this conference we have secured 43 new members, which indicates that the interest in the National Tax Association is increasing annually.

HENRY F. LONG (Massachusetts): Mr. Secretary, before you sit down, was there at any of the conference meetings a notice of the number of delegates or people attending the conference?

SECRETARY W. G. QUERY: I tried to get Judge Leser to announce that tonight, but he said in view of the fact that the speaker from Baltimore might feel just a little bit badly about having just a few people here when at previous sessions we had had hundreds, he wouldn't announce it.

PRESIDENT LESER: Inasmuch as he is gone and Mr. Edmonds doesn't mind and understands, I am perfectly willing to disclose that little secret.

SECRETARY W. G. QUERY: There were 40 states, 2 Canadian provinces and 1 foreign country represented, with a total attendance of 625 delegates, 23 from Maryland and 602 from non-host states.

PRESIDENT LESER: The next order of business is the report of the treasurer, Mr. Eby.

REPORT OF TREASURER
Year ending June 30, 1937

RECEIPTS AND DISBURSEMENTS

Balance in bank July 1, 1936 \$3,085.04

RECEIPTS

Association Activities

Dues	\$5,420.00
Sales of publications	731.65
Subscriptions to <i>Bulletin</i>	162.00
Miscellaneous receipts	5.15
Total	<u>\$6,318.80</u>

Investment Income

Interest	\$1,333.25
Dividends	188.40
Total	<u>\$1,521.65</u>

Received on exchange of stock	\$ 4.00
Received from bond redemptions	7,530.00
Total	<u>\$7,534.00</u>

Total receipts	<u>\$15,374.45</u>
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Total balance in bank and receipts	<u>\$18,459.49</u>
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DISBURSEMENTS

Administrative

Secretary—Clerical services	\$1,500.00
Postage, printing and stationery	278.33
Miscellaneous	1.90
Total	<u>\$1,780.23</u>

Proceedings

Printing Vol. No. 29	\$2,314.81
Reprints	40.81
Total	<u>\$2,355.62</u>

Bulletin

Printing Vol. No. 22	\$1,788.21
Reprints	41.58
Total	<u>\$1,829.79</u>

Conference

Reporter—Minutes	\$ 328.97
“ —Expenses	57.20
Printing and postage	88.19
Transportation, telegrams, etc	63.20
Total	<u>\$ 537.56</u>

Miscellaneous

Storage	\$ 11.25
Rental of safe deposit box	8.25
Exchange on checks deposited	1.93
Total	<u>\$ 21.43</u>

Funds Invested

Cost of bonds purchased (less interest accrued) ..	<u>\$9,920.00</u>
Total disbursements	<u>\$16,444.63</u>
Balance in bank June 30, 1937	<u><u>\$2,014.86</u></u>

From this statement of receipts and disbursements is summarized the following.

INCOME STATEMENT

*Association Activities**Income*

Dues, sales of publications, subscriptions to bulletin and miscellaneous receipts	\$6,318.80
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Expense

Administrative, proceedings, bulletin, conference and miscellaneous expenses	6,524.63
Excess of expense over income	<u>\$ 205.83</u>

Investment Income

Interest and dividends	<u>\$1,521.65</u>
Net income	<u><u>\$1,315.82</u></u>

NET PROFIT ON REDEMPTION OF BONDS

During the year, bonds which cost \$6,771.25 were redeemed for \$7,530.00, resulting in a net profit of \$758.75.

CHANGES IN INVESTMENT SECURITIES

Book value of securities July 1, 1936		\$30,184.67
Cost of bonds acquired	\$9,920.00	
Received for bonds redeemed	\$6,771.25	
Received on exchange of stock	4.00	6,775.25
Net increase		<u>3,144.75</u>
Book value of securities June 30, 1937		<u><u>\$33,329.42</u></u>

As of June 30, 1937, the securities had a market value of \$32,696.00, or \$633.42 less than cost.

(S) ROBERT J. EBY,
Treasurer.

REPORT OF AUDIT

I have audited the accounts of the National Tax Association as maintained by the treasurer for the year ended June 30, 1937, and verified the securities owned as at that date by personal examination. All cash received during the period, according to reports and other records in file, was found to have been deposited in bank to the credit of the association, and all disbursements were supported by receipted bills or other satisfactory data.

Subject to the foregoing, it is my opinion that the appended report of treasurer correctly sets forth the results of the association's activities for the year and its financial condition at June 30, 1937.

(S) EDWARD F. NEAL,
Auditor.

NEW YORK, NEW YORK
OCTOBER 20, 1937.

PRESIDENT LESER: What is your pleasure regarding the reports of the secretary and of the treasurer?

CLARENCE L. TURNER (Pennsylvania): I move they be accepted and printed in bound volume.

(The motion was duly seconded)

PRESIDENT LESER: Gentlemen, you have heard the motion to receive and print the reports of the secretary and treasurer. As many as favor the motion will say, aye.

(Ayes)

PRESIDENT LESER: Opposed, no.

(None)

PRESIDENT LESER: I don't hear anybody in opposition.

The next heading, according to my coach, is any other matters to come before the business meeting. Has anyone else anything that is pressing for utterance?

MR. LONG: Mr. President, last year at Indianapolis there was laid on the table an amendment to the by-laws to care for what might in the election of the officers be a hiatus between the time that the new man should take office and the old officer should go out.

I would like to move that that be taken from the table so that consideration can be given to it. I so move.

PRESIDENT LESER: I may say, while Mr. Query is looking for it, that if that had been adopted a year ago I would have served about ten minutes longer than I am going to serve. I was in favor of it then.

SECRETARY W. G. QUERY: The proposed amendment to section 1 of article IV of the by-laws was the addition of the following sentence: "Their terms of office shall begin thirty days after the date of the meeting at which they are elected, and they shall hold office until the terms of office of their successors begin."

MR. LONG: Mr. President, of course the objective is not necessarily to press for any particular period, whether it is thirty days or three minutes, but under the present plan, which was a continuation of the old plan when the group was an association and it didn't make so much difference, the president retiring might have served eleven months or thirteen months, depending upon the time when the annual conference was held. Since the group has become incorporated, it would seem advisable to have some very definite period that the officers should serve, or in the absence of that to have in the by-laws the very definite provision that an officer once elected would serve until his successor was qualified.

At least twice in the experience of the association within a comparatively few years, officers have been selected who were not present at the time that the selection was made. For example, last year the newly-elected president picked up the meeting half way through and carried forward as a newly-elected officer.

That seems to be contrary to good practice and contrary to what appears to be a logical arrangement, namely, that the president, to use Judge Leser as an example, should continue with all of the Baltimore proceedings and that the minute the association meeting was concluded in Baltimore, the new president would then become the president.

So if this is taken from the table I hope the amendment will be passed not with the thirty-day provision but with the provision that the president hold office until the new officer or officers are qualified.

I suppose that it will be necessary, Mr. President, to take that from the table before we can act on that proposal.

SECRETARY W. G. QUERY: The section which is proposed to be amended reads as follows, and I think I had better read the entire paragraph so you can catch the connection. It is under article IV, section 1, Officers and Executive Committee:

"The affairs of the association shall be administered by a president, a vice-president, a secretary, a treasurer, and an executive committee, consisting of the above officers and the three ex-presidents who have last held office, who shall be members ex-officio, and nine elected members. The necessary number of the three last ex-presidents of the National Tax Association, an unincorporated association, shall be members ex-officio, so long as necessary to make the number in that class three."

"The officers shall be elected annually by the members and, with the exception of the president, shall be eligible to re-election." The proposed amendment strikes out the following sentence, "They shall hold office until their successors are elected," and inserts in lieu thereof the sentence, "Their terms of office shall begin thirty days after the date of the meeting at which they are elected and they shall hold office until the terms of office of their successors begin."

PRESIDENT LESER: There is a very peculiar and very fortunate provision there, and that is that the president cannot be reelected. That guarantees this association forever from ever having me in office again.

Your motion, Mr. Long, is to adopt the resolution that was before the house a year ago and laid on the table?

MR. LONG: I think, Mr. President, it would be fair. I am assuming that no one is going to object to the general proposal that we have a definite time in which the officers take over their duties.

I think also it would be commonly agreed that it isn't good, in corporate form at least, for a new president to step in in the middle of a meeting, as is necessary under our present arrangement. I have confidence, I will publicly state, in the present president, that he will carry forward the rest of this meeting with due caution. I am glad to say that even in the state of Maryland, while I have confidence in the new president, maybe I haven't the confidence that I believe he should push out the old president to join the ranks of forgotten men while he is still in the city of Baltimore.

So I hope that the amendment will be adopted, but with a change, so that the thirty-day provision will not be there, if there is some other suggestion that can be made.

PRESIDENT LESER: You want to substitute a change so the officers will take office immediately after the annual meeting?

MR. LONG: Immediately after the annual meeting. You recall that when Clarence Smith, I think it was, of Kansas, was named, and I think one other, they were not present. Neither the president-elect nor the vice-president-elect were present at our meeting, and as a result we had to pass a vote to allow the old president to carry forward.

PRESIDENT LESER: Then the motion is to adopt this amendment as modified so as to substitute for the thirty-day provision a provision "immediately after the annual meeting."

JAMES L. SAYLER (Illinois): I would like to speak to one thing Mr. Long said. My recollection is that a year ago some question arose; for instance, upon a change of officers there would be some change in the certificates of the bank where we had deposits, and there would be some advantages in not having the new president come in immediately but have a sufficient length of time elapse after the conference so that details about the change of right to sign checks or withdraw securities and that sort of thing could be put into operation. I really see no objection to Mr. Long's original motion making it thirty days.

MR. LONG: I am very glad to have Mr. Sayler say that, because last year there was some objection, and it is true, as Mr. Sayler suggests, that there are necessary adjustments that have to be made.

PRESIDENT LESER: Then you withdraw that suggestion and move for the adoption of the resolution as originally offered?

MR. LONG: As suggested, that is correct.

PRESIDENT LESER: Gentlemen, that motion is before you. You have heard it, and I am assuming you don't want to debate it until midnight.

Is there a second?

(The motion was duly seconded)

PRESIDENT LESER: Gentlemen, I will take the vote. As many as favor that amendment, signify by saying, aye.

(Ayes)

PRESIDENT LESER: Opposed, no.

(None)

PRESIDENT LESER: Carried, unanimously.

(Simeon E. Leland took the chair temporarily)

MR. EBY: Mr. Holcomb has suggested an amendment to the certificate of incorporation. The purpose of the amendment is to take care of this situation: in the event that sometime the association should discontinue as an association some provision should be made

for the turning over of the assets to some association or other body that would carry on the work of the National Tax Association, or work of the same nature in which it is now interested. The resolution is as follows:

WHEREAS, it appears desirable and important that the aims and purposes of the National Tax Association and its scientific, educational and philanthropic character, as outlined in its certificate of incorporation, be emphasized and perpetuated:

THEREFORE BE IT RESOLVED, that the officers of the association be authorized and directed to secure, under advice of counsel, an amendment of the certificate of incorporation, at an appropriate point therein, in substantially the following form:

"In the event of the dissolution of the corporation or the discontinuance of its activities, its property and assets shall be donated to one or more such organizations or institutions as in the judgment of the executive committee or other managing body then in office will best use such property in the promotion of the aims and purposes expressed in this certificate."

SECRETARY W. G. QUERY: I might say this, that at the meeting of the executive committee on Monday afternoon this proposal to amend the certificate of incorporation was placed before the executive committee, and a motion was adopted by the committee that the proposal be approved and the proper officials of the association be authorized to take steps necessary for such amendment.

MR. LELAND: It seems that there are certain provisions in the internal revenue act and other federal laws for the taxation of a corporation, to the effect that if at any time an association such as ours has any resources and upon dissolution there is the likelihood that those resources shall inure to the benefit of individuals or concerns for profit, that they may suffer the consequences of current taxation, and in order to demonstrate our continued immunity from capital stock and certain other federal taxes, it appeared to Mr. Holcomb and to the executive committee that the adoption of this change in our charter was desirable.

It has been looked into by some of the association's lawyers and by the executive committee, and I would think that a motion should be made that this change in the certificate of incorporation should be made.

FRANKLIN S. EDMONDS (Pennsylvania): The proposition itself is very simple and I think it should appeal to everybody as entirely feasible, namely, in the event of dissolution that the funds of the association shall be given by the executive committee to an association which is carrying on work similar to this. That seems to me to be entirely clear.

MR. SAYLER: Mr. Chairman, I don't want to be taking the negative on things here. This is all news to me. I don't know how the District of Columbia is, but I know in some states, for instance, Illinois, there is danger in putting in a provision of that kind, that is, giving one association the power to give to another. In the last analysis, in most cases, it is uncertain, if the charter is surrendered, what is to be done. You would have to get a court order as to what to do with it.

MR. LELAND: In the absence of this provision, it was the opinion that the only thing to be done with the funds was to divide them up among the then current members, and in order to guarantee the further exemption under the statutes of the District of Columbia in some of these situations Mr. Holcomb found, it was thought desirable to have this provision inserted in the charter.

MR. SAYLER: Of course, it would be very true that if you assumed a set of facts where the money is to be divided among the members, we would be denied an exemption. The only point I raised—and I should perhaps not speak on this without more study—is that I think there is danger, or would be in some cases, in providing that one corporation has the right to vote this matter and turn it over to another company, in other words, to determine whether another association would follow out the same general lines that we do. It may be that under the District of Columbia rules it is okeh, but I just wanted to raise a question about it.

MR. EDMONDS: I think, in answer to Mr. Sayler's question, this matter would have to go before the courts of the District of Columbia and would have to have the consent and the approval of our District of Columbia counsel who got the original charter for us, so I think that is covered.

(President Leser returned to the chair)

MR. SAYLER: I have this suggestion to make—I don't know whether it has been done or not—but I think that Mr. Holliday's judgment on the thing should be taken before final action is put through on it.

PRESIDENT LESER: That is provided for.

FRANKLIN S. EDMONDS: Mr. President, I move that the change in the certificate of incorporation of the National Tax Association, which has been endorsed by the executive committee, be made.

SIMEON E. LELAND: I second Mr. Edmonds' motion.

PRESIDENT LESER: As many as favor adopting the proposed amendment to the certificate of incorporation will signify by saying, aye.

(Ayes)

PRESIDENT LESER: Opposed, no.

(None)

PRESIDENT LESER: It is unanimous.

The next order of business is the very interesting report of the nominations committee, of which Mr. Holcomb is chairman and for whom the Honorable Henry F. Long will pinch-hit.

MR. LONG: Mr. President, Mr. Holcomb was unfortunately called away, and he asked me to make the report for the committee. I am going to ask if I am correct in understanding that the committee in making its report reads all of the suggestions made for each of the officers and then that the vote is taken separately rather than for each officer to be called to attention separately.

SECRETARY W. G. QUERY: No, sir, you make the report and then one vote is cast for the officers reported in the nominations committee.

MR. LONG: I will read, then, the paper as given to me.

To the Members of the National Tax Association in annual meeting assembled:

We, the undersigned, duly appointed members of a committee on nominations to suggest persons to be elected as officers and members of the executive committee of the association at this annual meeting, hereby report as follows:

We recommend the election of the following persons to the offices and for the terms specified:

For officers, to hold office for the ensuing year and until their successors are elected:

President: Simeon E. Leland of Illinois.

Vice-President: A. H. Stone of Mississippi.

Secretary: W. G. Query of South Carolina.

Treasurer: Robert J. Eby of New York.

For members of the executive committee for terms expiring in 1940:

James H. Thayer Martin of New Jersey.

Raymond D. Thomas of Oklahoma.

Charles D. Rosa of Wisconsin.

For member of the executive committee for the term expiring in 1939, to fill the vacancy which will be created by the election of A. H. Stone as Vice-President:

J. B. Jones of Alabama.

For honorary members of the executive committee from Canada, to hold office for the ensuing year and until their successors are elected:

L. I. McMahon of Montreal.

A. K. Eaton of the Department of Finance of Canada.

Respectfully submitted,

FRED R. FAIRCHILD,	Past President
HARLEY L. LUTZ,	Past President
ROBERT M. HAIG,	Past President
FRANKLIN S. EDMONDS,	Past President
HENRY F. LONG,	Past President
PHILIP ZOERCHER,	Past President
CARL S. LAMB,	
FARWELL KNAPP,	
C. M. BROWN,	
ALFRED E. HOLCOMB,	Past President
	Chairman.

PRESIDENT LESER: You will notice the great number of past presidents. I believe it breaks the record, and as I said the other day, there will be one more in a few minutes.

Gentlemen, what is your pleasure?

A. J. MAXWELL (North Carolina): Mr. President, I move the report of the committee be adopted by the association as a whole.

(The motion was duly seconded)

PRESIDENT LESER: It is moved and seconded that the report of the committee, which will carry with it the election of these nominees, be adopted.

As many as are in favor of that motion will signify by saying, aye.

(Ayes)

PRESIDENT LESER: Opposed, no.

(None)

PRESIDENT LESER: Unanimous! These officers go in with the unanimous approval of the National Tax Association.

The next order of procedure is to induct, if not to induce, the new officers in their new official positions. I call on President Leland.

Take the gavel.

PRESIDENT-ELECT LELAND: I really shouldn't say anything for thirty days. I have already said far too much.

I want to tell you I greatly appreciate the honor you have bestowed on me, and I will do my best to discharge the duties of this

office with decorum and try to find some qualifications for the job in the next thirty days.

I think that we ought to congratulate the present president during the remaining thirty days of his office upon the kind of a program that he has provided for this conference. I think this has been one of the best conferences that we have had, and it has set a high standard which we, the new officers, shall hope to equal during the next year.

We will do our best to make the affairs of the association run smoothly and if any of you have any suggestions for the improvement of the association or things you want to discuss on its program next year, I will greatly appreciate it if you will send them to me. I will assure you of one thing, you will not have a new deal, but you may get a raw one.

PRESIDENT LESER: I must disclaim that part of the statement which gives me credit for the program. I had a very minor part to play in that. We appointed a committee and the committee did the work, and it was a very efficient committee, consisting of Dr. Gerstenberg, Mr. Girdwood, Mr. Query, and Professor Lutz.

We are now ready to receive a word of encouragement from the new vice-president. I take pleasure in presenting him because, as I think has been stated before, he and I were born on the same day, not merely on the same day of some year, but on the same day. He is my twin brother, and as I am already a twin, why, naturally, we are triplets. He is coming forward to say a word to you now.

VICE-PRESIDENT-ELECT STONE: Mr. President, Ladies and Gentlemen, I don't know whether you are going to believe me or not, but it is literally true that I am probably as much taken by surprise on this occasion and by this announcement as anybody else in the room.

I can not imagine any reason why I should be selected as vice-president of the leading tax body of America. I know of a good many reasons why a good many other men should have been selected. I suggested one friend of mine to some members of the committee, and I am sure this organization would have been benefited by his selection rather than mine. However, I don't want to be understood as finding fault with the selection of the committee.

I want to accept it, and do so graciously, and I do it with a very sincere appreciation, not only of the compliment involved in this selection, but also with an assurance of my full apprehension of the responsibilities and of the possibilities offered by the proper administration of whatever the duties of the vice-president may be.

I know that it has become customary, through some one hundred and fifty years of usage, for vice-presidents to be seen and not heard. It isn't very often that you are going to hear from me. But I want to take this opportunity to say something which I have said

a great many times in a great many places at gatherings of people from different sections of America.

I am one of the old-fashioned individuals who thinks that we are still living under an experimental democracy. I think the government which our forefathers brought forth on this continent a hundred and fifty years ago to test whether or not a people scattered from the Atlantic to the Pacific—as we have developed it and not as it was at that time, of course—and from the Canadian border to the Gulf of Mexico, a people numbering one hundred and twenty to one hundred and thirty millions, with an endless diversity of natural resources, of economic interests, of social, industrial and economic outlooks, is competent to discharge in a full measure the duties and responsibilities of self-government.

For myself I can express my own faith in the belief that we can do it. Also I would qualify that by saying that we can do it only in so far as we learn to know each other, only in so far as we become acquainted with each others' problems, only in so far as we can realize that the man right next to us with his individual problem is entitled to our consideration, entitled to our cooperative help, and only in so far as we heed George Washington's injunction in his farewell message, to not think of ourselves and our country in terms of sectional distributions, but really as one people, and we can do that better, I think, than any other way, by coming together in gatherings of this kind.

If there is any one thing which does demand a concession, a give-and-take spirit, a comprehension of our difficulties, a sympathetic attitude toward each other, it is the problem which this association is called on to discuss from time to time.

I want to again assure you of my sincere appreciation of the opportunity to contribute toward that end in so far as I may be capable of doing so.

PRESIDENT LESER: Gentlemen, I want to make public acknowledgment of the great kindness and courtesy of the gentleman from South Carolina giving me a gavel which I have liberally used.

Mr. Query advises me that he would like to make a very brief statement, but before he does so, I thought you might like to hear a few words from a gentleman who has been terribly quiet at this session. I have heard complaints, too, about it, and it is the feeling that he may have some ailment of the throat. But time is short and his statement must be brief, as much as two minutes or three minutes.

I am sure all of us would be glad to hear from a member of the executive committee, one who has attended for many years our sessions and a man who is an enthusiast, Mr. McMahon of Montreal.

L. I. McMAHON (Montreal, Canada): Mr. President, Ladies and Gentlemen: I thank you, sir, for the very kind introduction you

have made of me to this meeting, and I would be positively discourteous were I not, as the sole representative of a most friendly nation present at the time, to accede to the request.

I was delegated a year ago to try and interest the respective governments of Canada, and particularly our federal government of Canada, in the meetings of this association. With the experience that I had gained over a period of years, I was successful in having the federal government of Canada only last week accede to the request. It sent to the meeting last year as an observer, and this year with the intention of becoming an honorary member from Canada, representing the federal government, Dr. A. K. Eaton, of the department of finance of the Dominion. I succeeded and I feel that we should express our very, very deep gratitude for the courtesies extended. No doubt we shall endeavor to add to the interests of this association whatever we may be able to do in that regard, and I think that it would be possible to do very much.

You heard from Dr. Eaton only today, and I am sure that holding the position that he does he could give a paper next year or at any time that you would want him to that would be very, very interesting to put alongside of the papers on somewhat similar subjects that are delivered here.

The idea is that this most friendly nation will become more friendly, and that each help the other out. I think we can achieve that.

It was said of Tim Sullivan once that he approached President Cleveland at Washington and asked a personal favor. The president refused him, and big Tim said, "Well, why?"

The president retorted that it was against the constitution. "Why, Mr. President," he said, "what is a constitution among friends?"

I have enjoyed the courtesies and hospitality of this association and the members in this country so long that I am almost doubtful if there is even an imaginary line between you and us, so far as I am concerned, and I hope for many years to come that I shall be an attendant at these meetings.

A very successful business man who had just retired took up golf, and was playing, as he thought, the game. But his deficiencies in golf were more than compensated for in his heavy tips to the caddies. He usually handed out a very considerable amount.

One day a little darkie who had lost his job in the corn field was caddying for him. When he was through he handed out this rather heavy tip as was usual with him, and the little "nigger" looked up in surprise and said, "Say, boss, is you goin' to be diggin' again around here tomorrow about this time?"

I am sure that wherever the convention may be next year you will find Dr. Eaton and me endeavoring to do all we can to increase the amity between these two nations which are really an example

before the whole world, particularly with the stress and struggle we see beyond our borders.

VICE-PRESIDENT-ELECT STONE: In my confusion a while ago, I realized when I sat down that I had failed to say one thing which I, in thinking it over, have most at heart, and which I consider most important in connection with your action in selecting me as vice-president, and that is that it gives me continued opportunity for closer association with Simeon Leland.

PRESIDENT LESER: The last word that I will have an opportunity to say, except to adjourn, is simply to remark that the reference to Tim Sullivan reminds me of an awfully good story on Tim Sullivan. There is a possibility it may be of "Silver Dollar" Sullivan, but it was one of the Sullivans who was in congress and wanted to be recognized by Speaker Reed. He visited him in his private quarters to make arrangements beforehand and the speaker said, "Well, what is the matter? What do you want to bring up?"

He explained what the resolution was and said, "It is a matter of the greatest possible interest to the laboring people of the United States."

Tom Reed drawled out, "Oh, you give me a pain. To hell with the laboring people."

"Why," Tim said, "Mr. Speaker, do you realize what you say? Imagine my getting up on the floor of the house and repeating this conversation. What would you say?"

"My dear sir," said the speaker, "if you did that you would put me to the painful necessity of branding you as a damn liar."

Now we will hear from Mr. Query, and that will be the last word.

SECRETARY W. G. QUERY: Mr. President and Friends, I am not going to make a talk.

I would be ungrateful if I didn't take this opportunity, however, of expressing my appreciation for the confidence which the National Tax Association, through its past presidents and its appointed members comprising the nominations committee, has in me. I have tried, and will continue to try as long as I am the secretary, to perform the secretarial work of the association. It isn't easy work, but my reward comes in the very fine associations which I have made during the last ten years, and I want to state how much I enjoy and value the very fine friendships which I have made.

I have been closely associated with the past presidents, and I have enjoyed working with my esteemed friend, Judge Leser. He has been considerate of me, he has been helpful, and I have grown to esteem him very much.

I didn't rise to do other than to express in a serious mien the way I feel about the work that this great group of people is doing for the improvement of tax administration throughout the United States.

You may not know it as well as I, but I do know that in practically every state in the American union, the National Tax Association and its work are held in the highest esteem, and I am proud that I am contributing in a small way to the work which it is doing.

PRESIDENT LESER: Gentlemen, I may be permitted to say that I reciprocate the sentiments of the secretary, and I can testify that he has been a darn sight more use to this association than any president we ever had. Of course, the new president isn't included in that because he may not justify the remark.

It has been a pleasure to serve. It is the first time in the history of our thirty years' existence that the president who officiated during the conference officiated to the bitter end.

MR. LONG: Wouldn't it be well, Mr. President, before you pronounce those words of benediction you are about to utter to notice the time on your watch so that you will go down in the record as being the long last president?

PRESIDENT LESER: Well, I don't know. King Edward said "long last" and it was a mighty portentous statement. I won't use it.

Gentlemen, I will entertain a motion to adjourn. Mr. Zoercher usually has put that motion—about twenty times in succession.

MR. EDMONDS: I move the association now adjourn.

PRESIDENT LESER: Our new mover now moves the association adjourn.

(The motion was duly seconded)

PRESIDENT LESER: The meeting is adjourned.

(Final adjournment)

ATTENDANCE AT THE THIRTIETH ANNUAL CONFERENCE

ALABAMA

Curry, John C.	Chief Clerk, State Tax Comm.	Montgomery
Curry, Mrs. John C.		Montgomery
Davis, C. L.	108 W. 5th St., O.P.	Montgomery

CALIFORNIA

Ellsworth, Von T.	Head Research Dept. Calif. Bureau Federation, 328 Hilgard Hall	Berkeley
Gentry, W. H. H.	State Inheritance Tax Att'y, 1340 40th Street	Sacramento
Keesling, Frank M.	Clerk, Franchise Tax Com'rs Office, Plaza Bldg.	Sacramento
Kepple, Gerald C.	Member, State Legislature, 306-308 Bank of America Bldg.	Whittier
McColgan, Charles J.	Franchise Tax Commissioner, Plaza Building	Sacramento
Mott, A. G.	Dir. of Valuation—State Board of Equalization	Sacramento
Mott, Mrs. A. G.	3700 College Ave.	Sacramento
Pierce, Dixwell L.	Sec'y State Bd. of Equalization, 129 State Capitol	Sacramento
Stevens, Harley	Manager, Standard Oil Co. Calif., Tax Dept., Standard Oil Bldg.	San Francisco
Sutherland, H. J.	Tax Agent, Western Pacific R. R. Co., Rm. 873 Mills Bldg.	San Francisco
Sutherland, Mrs. H. J.		San Francisco
Thompson, Frank	Tax Agent, A. T. & S. F. Ry., 1540 North Pacific Ave.	Glendale
Thompson, Mrs. Frank	1540 North Pacific Ave.	Glendale

COLORADO

Bedford, Homer F.	State Treasurer	Denver
Bedford, Mrs. Homer F.		Denver
Crews, F. H.	Treas., Crews Beggs D. G. Co.	Pueblo
Crews, Mrs. F. H.		Pueblo
Daniels, J. Walt	County Assessor	Ft. Morgan
Hetherington, George	State Inheritance Tax Com'nr, 305 State Capitol	Denver
Hetherington, Mrs. Geo.	1255 Penn St.	Denver
McInroy, James P.	Member, Colorado Tax Comm., 328 State Office Bldg.	Denver
Seaman, John R.	Chrmn., Colorado Tax Comm.,	

Toll, Henry W.	State Office Bldg. Exec. Director, Council of State Government	Denver Denver
Yale, Frank	Land & Tax Agent, Colo. Fuel & Iron Corp., 1407 E. 10th Ave.	Denver
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CONNECTICUT

Dauch, Frederic	Deputy State Tax Comm'r	Waterbury
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Johnson, Mrs. C. L.	Tax Attorney, State of Conn., 502 Whalley Ave.	New Haven
Johnson, John J.	Marsh, Stoddard & Day, 886 Main St.	Bridgeport
Knapp, Farwell	Research Tax Director, State Tax Dept., 57 Allen Place	Hartford
Potter, Arthur F.	Dir. of Budget, State of Conn., 33 Lincoln Road	Wethersfield

DISTRICT OF COLUMBIA

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Carruthers, L. A.	Bureau of Census	Washington
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Colladay, E. F.	Attorney at Law, 1331 G St., N.W.	Washington
Englund, Eric	Ass't Chief, Bureau of Agri. Econ., U. S. Dept. of Agri.	Washington
Gall, Alexander	Social Security Board, 1736 Columbia Road	Washington
Gerrity, Harry J.	Gen. Counsel, Nat'l Ass'n of Bldg. Owners & Managers, 1001 Hill Bldg.	Washington
Gray, Welles A.	U. S. Chamber of Commerce, 1615 H Street, N.W.	Washington
Isaac, Gerhard J.	U. S. Dept. of Agriculture	Washington
Littlepage, Thomas P.	Littlepage & Littlepage, Bowen Building	Washington
MacLeod, D. R.	Fruit Growers Express Co., 1101 Vermont Ave.	Washington
Magill, Roswell	Under Sec'y of the Treasury, U. S. Treasury Dept.	Washington
Manning, Raymond E.	Library of Congress	Washington
Manning, Mrs. R. E.		Washington
Moore, Blaine F.	U. S. Chamber of Commerce, 1615 H St., N.W.	Washington

Mullen, Mrs. D. C.		Washington
Nelson, Richard W.	U. S. Forest Service	Washington
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Savoy, Prew	Attorney, Munsey Bldg.	Washington
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Woodworth, Leo Day	U. S. Senate, Spl. Comm. to Investigate Unemployment & Relief—University Club	Washington
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DELAWARE

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Daugherty, M. M.	University of Delaware	Newark
Gorman, Lester B.	DuPont & Co.	Wilmington
Holcombe, J. L.	The Coca Cola Co.	New Castle
Holcombe, Mrs. J. L.		New Castle
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Pippin, R. R.	DuPont & Co.	Wilmington
Schreiber, L.	DuPont & Co.	Wilmington
Truss, James N.	Ass't State Tax Comm'r, 2 E. 9th St.	Wilmington

FLORIDA

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GEORGIA

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Faricy, Wm. T.	Chi. & Northwestern Ry. Co., 400 West Madison St.	Chicago
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Fischer, Mrs. K. W.	547 West Jackson Blvd.	Chicago
Gillman, J. B.	R. I. & Southern Ry. Co.	Rock Island
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Hessler, W. G.	Asst. Mgr. Tax Dept., U. S. Gypsum Co., 300 W. Adams St.	Chicago
Hunter, M. H.	Professor of Economics, University of Illinois	Urbana
Hunter, Mrs. M. H.		Urbana
Huntington, Frank B.	Gen. Auditor, Balto. & Ohio C. T. R. R., Grand Central Station	Chicago

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Lepawsky, Albert	Federation of Tax Administra- tors, 850 E. 58th St.	Chicago
Marshall, Logan W.	The Pure Oil Co.	Chicago
McKittrick, L. F.	Armour & Co., Tax Dept., U. S. Yards	Chicago
Miller, R. A.	Tax Commissioner, Chicago & Northwestern Ry. Co., 400 W. Madison St.	Chicago
Mitchell, Geo. W.	Statistician, Ill. Tax Comm., 5453 Woodlawn Ave.	Chicago
Moore, Paul H.	Winston, Shawn & Shaw	Geneva
Moore, Mrs. Paul H.	1010 Hawthorne Lane	Geneva
Nance, Willis D.	Kirkland, Fleming, Green, Martin & Ellis, 33 N. LaSalle St.	Chicago
Noonan, Albert W.	Exec. Dir., Nat'l Ass'n of Assessing Officers, 850 E. 58th St.	Chicago
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Olson, Mrs. Alvin B.	3000 Sheridan Rd.	Chicago
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Sayler, James L.	Taxation Counsel, Halsey, Stuart & Co., Inc., 201 S. LaSalle St.	Chicago
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Schlichting, Justus	President, Commerce Clearing House, Inc., 205 W. Monroe St.	Chicago
Schulz, Edgar F.	Real Estate & Tax Agent, Chi. & Ill. Midland Ry. Co., 908 W. Lawrence Ave.	Springfield
Schulz, Mrs. Edgar F.		Springfield
Schwartz, Charles K.	Member, Illinois Tax Comm., 33 N. LaSalle St.	Chicago
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Simpson, Mrs. H. D.	2520 Marcy Ave.	Evanston
Stice, Maurice		Shelbyville
Sutherland, Douglas	Civic Federation & Bureau of Public Efficiency, 160 N. LaSalle St.	Chicago
Sutherland, Mrs. Douglas		Chicago
Terry, Charles W.	Member, Ill. Tax Commission, National Bank Bldg.	Edwardsville

Tunell, George G.	Commissioner of Taxes, Santa Fe Ry. System	Chicago
Tunell, Mrs. Geo. G.		Chicago
Watson, Deneen	11 S. LaSalle St.	Chicago
Watson, Mrs. Deneen		Chicago
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Wimsey, Mrs. Paul J.	6931 Crandon Ave., Apt. 5-B	Chicago
Wise, William N.	Editor, The Tax Magazine, 205 W. Monroe St.	Chicago

INDIANA

Benjamin, C. R.	Member, State Tax Comm.	Indianapolis
Cameron, William C.	Co. Assessor, Howard County	Kokomo
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Dawson, Chas. M.	Sec'y-Treas. Indiana Township Trustee Association, 2028 E. 62nd St.	Indianapolis
Jackson, Clarence A.	Gross Income, Chain Store. Unemployment Compensation	Indianapolis
Ketchum, Anderson	Sec'y State Tax Commission	Indianapolis
Ketchum, Mrs. Anderson	948 N. Lesley St.	Indianapolis
Kochis, George	County Assessor, 1837 Cleveland Ave.	Whiting
Koenemann, Edward	County Assessor	Evansville
Martin, Frank R.	Mayor, 220 Vine St.	Hammond
Miesse, Harry	Indiana Taxpayers Assn., 819 Hume-Mansur	Indianapolis
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Williams, Marshall	State Tax Commissioner, 2845 N. Penn St.	Indianapolis
Williams, Mrs. Marshall	2845 N. Penn St.	Indianapolis
Zoercher, Philip	Chrmn., State Board of Tax Com'rs, 68 Whittier Place	Indianapolis
Zoercher, Mrs. Philip	68 Whittier Place	Indianapolis

IOWA

Fowler, Rex H.	Attorney, 510 Crocker Bldg.	Des Moines
Long, Joe	Exec. Secy., Iowa Taxpayers Association, 501 Insurance Exchange Bldg.	Des Moines
Murtagh, C. B.	State Controller	Des Moines
Murrow, D. L.	Member, State Bureau of Assessment & Review, 5219 Shriver Ave.	Des Moines
Rininsland, H. A.	Dir., Div. of Retail Sales & Use Tax Div., State Tax Comm.	Des Moines
Roddewig, Louis E.	Chairman, State Board of Assessment & Review	Des Moines
Sayre, C. H.	Asst., Dir. State Income Tax Div., State Tax Comm.	Des Moines

Sweany, E. Mae	State Bd. of Assessment & Review, 1166 26th St.	Des Moines
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KANSAS

Ayers, Walter C.	County Assessor, 1234 Mulvane St.	Topeka
Ayers, Mrs. W. C.	1234 Mulvane St.	Topeka
Barkley, R. L.	State Income Dept., State Tax Commission	Topeka
Fink, W. G.	Chrmn., State Tax Comm.	Topeka
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